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## Equality of Opportunity in Decision Making:

### *Its Scope in Economic, Social and Political Processes*

By MADELYN L. KAFOGLIS

THE RESOLUTION OF CONFLICT through citizen participation in the decision-making process is receiving widespread attention at the levels of both theory and practice.<sup>1</sup> The emphasis on broader citizen participation in public affairs rests on the premise that in a democracy, consensus, as well as efficient decisions are more likely to be achieved if the decision-making process reflects the freely expressed values of the individuals affected. In short "citizen sovereignty" requires citizen participation in public affairs in the same sense that the principle of consumer sovereignty requires voluntary participation of individuals in free markets. The view that decisions concerning the allocation of resources, both private and public, should allow the widest possible action on the part of the individual seems essential in a democracy and, indeed, is basic in American tradition.

The rationale of antitrust policy has been to prevent restraints which hampered the determination of price and output through the free play of consumers and producers in the market place. The protection and special status of cooperatives reflects a preference for even more direct consumer participation in the processes of production and distribution. Likewise, the sympathetic attitude of the federal government toward labor unions during the 1930's reflected the notion that the individual laborer should

<sup>1</sup> Of especial significance are the works of James Buchanan and Gordon Tullock, *Calculus of Consent* (Ann Arbor: University of Michigan Press, 1963) and Mancur Olson, Jr., *The Logic of Collective Action* (Cambridge, Massachusetts: Harvard University Press, 1965).

be free to organize in order to participate on a more equal basis in decisions which affected him directly—his wages and his working conditions.

In more recent years, labor legislation has attempted to protect the individual's right to participate, without coercion, in the labor organization to which he belongs as well as his right not to participate. The efforts of the courts to open voting rolls to eligible but disfranchised citizens and to force the reapportionment of state legislatures is further evidence of the view that wider citizen participation will not only ameliorate inequalities in power relationships, but will contribute to efficiency in resource use. For example, failures in city planning, redevelopment, and renewal frequently are traced to a failure to develop citizen participation at crucial stages.

## I

### The Rationale of Participation

THE CONCERN with increased participation rests in part on the assumption that the present decision-making process fails to assimilate enough information about the desires of all citizens. Clearly, a process which increases the flow of relevant information should lead to improved decisions in the same sense that well-informed and rational markets lead to a superior allocation of resources in the private sector of the economy. This aspect of the problem calls for continuous flow and feed-back of information between politicians, bureaucrats and citizens.

However, any given body of information expressing the desires of citizens will lead to a different decision depending on the power relationship in which the information is evaluated. For example, a survey of the preferences of citizens concerning the location of a park is without policy significance until weights, intensities of feeling, are attached to the bits of information that have been gathered. It is felt that these intensities can be expressed most effectively if the citizen himself participates in the evaluation of information and is given a "voice" in the final outcome. This more political interpretation of participation involves distributive questions and rests on the assumption that public decisions should reflect equitable power relationships.

In the final analysis, the outcome depends on the distribution of both purchasing power and political power, each of which contributes some weight to the ultimate distribution of welfare—income, rights, amenities—among the citizenry. One would suspect that this outcome is not as unequal as the distribution of income, nor as equal as implied by a one-man, one-vote distribution of political power.

The emphasis on participation in political matters is a recognition that the distribution of political power deviates from the norm of equality and may not make its full contribution to the amelioration of inequality. Public policy now seems to be trying to mitigate the inequality of political power by the encouragement of increased participation of those groups whose disadvantaged economic position resulted in a disadvantaged political position or vice versa. Even coercive tactics are being used—"no participation, no funds"—to enforce a semblance of change in the level or mix of local participation.

Just as the attempt to redress economic inequality through progressive taxation and through programs of subsidy and transfers has sometimes gone awry, resulting in more rather than less inequality in the distribution of income, there is the danger of promoting unwittingly more political inequality through increased participation unless the objectives are carefully defined and the mechanisms built with complete recognition of the benefits and costs which accrue to individuals. Just as more and more transfers do not necessarily imply a lessening of income inequalities, so more and more participation will not necessarily result in a more equal distribution of political power.

Little is known about the specific benefits of participation beyond the generalities stated above. The cases in which increased participation has led to improved solutions can be matched by cases in which participation either failed to materialize or led to an inferior solution when it did materialize. There is as yet no categorization of the specific types of benefits that accrue as a result of participation, of the specific forms which participation should take or of the conditions necessary to achieve various types and levels of participation.

It is too often assumed that participation is a social "good" and that the benefits of participation like manna from heaven come without cost or important limitations in a never ending upward spiral as more and more persons become involved. However, there are costs, both social and private, associated with participation and in some cases the costs are more obvious than the benefits. Those who develop public programs involving participatory features must reckon with a calculation of costs and benefits to no less an extent than the potential participant who may decide that there are better things to do than attend the city commission meeting.

It is necessary to recognize the gains and costs to society and to the individual of the various mechanisms for citizen participation. The design of the mechanism is vitally important if a more desirable distribution of political power is to be accomplished. Unless the participatory mechanism

is designed in the light of benefits and costs to individuals, the result may simply be more participation by those who now hold the balance of economic and political power.

## II

### Collective Aspects of Participation

ALTHOUGH IT IS DIFFICULT to define, much less to measure the specific social benefits and costs that accrue as a result of participation, it is possible to examine various relationships that determine the amount and type of participation that will develop. Participation, whether formal as in voting, as a member of a citizens' advisory group or as a member of a watchdog group; or informal as in political discussion, letters to the editor, visits to city hall, personal contacts with public officials is an input into the decision process.

The costs of the input seem somewhat easier to evaluate than the value of the output. This is because most of the costs of participation are borne by the participant and can be evaluated by him. On the other hand, the benefits of participation include to a greater or lesser degree those general or collective benefits which accrue to others as a result of a citizen's participation. Thus, participation can yield both private and collective benefits.

The private benefits are those that accrue directly to the individual as a result of his active participation, for example, a change in a zoning ordinance which enhances the value of his property. The collective benefits of his activity are more diffuse and more difficult to evaluate. However, by presenting his own case he keeps the door open for others to present their point-of-view; and he keeps officials on their toes, more responsive to the demands of citizen. Moreover, any private gains the individual receives as a result of exercising his "rights" help to maintain and preserve the rights and privileges of others. Thus, the benefits of an individual's participation can be subdivided into those private benefits which accrue directly to the individual and those social benefits which accrue more or less "equally" to other members of the community.

The social benefits of participation, like national defense and law and order, are purely collective goods in the Samuelson sense.<sup>2</sup> The benefits accrue to all; no one individual can be excluded from the benefits which result from another person's participation. If the individual, when considering whether or not to participate, counts only his own private benefits

<sup>2</sup> Paul A. Samuelson, "The Pure Theory of Public Expenditures," *Review of Economics and Statistics*, Vol. 36 (1954) pp. 387-89.

and costs, the amount of participation will be inadequate for the same reason that adequate resources for national defense and law and order would not be forthcoming if individuals were asked to contribute voluntarily to these functions.

In the realm of politics and public goods the attitude is: let George do it and I'll enjoy it. This, the so-called free-rider problem, explains why special interest groups participate while others do not. For the interest group the gains of participation are direct and private—for the ordinary individual, most of the gains of participation are broadly collective accruing to other citizens. Thus, voluntary participation of the sort that leads to a large measure of collective benefits with a small proportion of private benefits is not likely to be forthcoming. Indeed, the active participant without a strong private interest is frequently viewed with considerable scepticism.

In the same way that the elimination of communicable disease may require that individuals themselves be vaccinated, so the benefits of participation cannot be achieved unless individuals themselves participate. The individual who participates is himself a public good whose participation yields spillover benefits which accrue to the entire community. Though most public goods can be financed through taxation, there are a number—education, vaccines and the like—which cannot be obtained without utilizing the individual himself as an input. This unique quality, which also characterizes participation, requires that it be considered in terms of a highly individualistic calculus. For example, if individuals on their own volition purchase vaccines, the collective benefits of a healthy environment will probably be attained. On the other hand, if for one reason or another they do not purchase vaccine in sufficient quantities to ensure a healthful environment, the question of vaccines will become a problem for public policy. Thus, the factors which encourage or discourage participation on the part of the individuals must be ascertained.

In spite of the fact that citizen involvement may improve the viability of the system, participation does not come without costs. Elections involve considerable outlay of funds and sometimes increased participation comes at the expense of information. The actions of a misinformed participant must be balanced against the presumed values of participation *per se*. Decision-making may be slowed down and made more cumbersome, imposing costs on citizens both individually and collectively. To the extent that the participant frustrates decision-making by seeking stubbornly to impose his own will, additional costs are imposed on other

citizens (who may, as a result, be driven out), not to mention public officials (who may, as a result, hold "secret" meetings). There is also the strong possibility that the private gains to the participant are more than offset by costs that ultimately are borne by others. An individual who successfully opposes a public housing project may impose important costs on others—costs which are large in total, but which are so diffuse, general and collective that they do not encourage participation from those on the other side of the fence.

It is extremely important that the institutions through which participation is achieved be developed in a manner which strikes a balance between the social costs and benefits of participation. This requires the development of decision rules, committees and other forms of representation along with a balanced reliance on experts and professionals. The definition of the collective entity itself may increase or decrease the social costs and benefits of participation. Though small and homogeneous units may be internally more efficient, their actions can have impacts on other groups. At the same time, broadening the entity to include a wider spectrum of participation introduces heterogeneity and does not come without costs in terms of decision-making efficiency. Though American society is pluralistic, significant gains can be achieved through the activities of homogeneous groups. A great deal of research remains to be done in the realm of optimal group size and in the appropriate combination of heterogeneous components.

### III

#### Individual Aspects of Participation

THOUGH NEITHER THE INFORMATION nor the analytical tools necessary to define and measure the social benefits and costs that accrue as a result of participation are presently available, additional insight can be acquired by examining costs and gains as they are viewed by the participant. The benefits of participation as viewed by individuals will, of course, differ from one person to another depending on the individual's role and status in the community, his personal objectives and his political and ethical beliefs.

For some individuals great personal satisfaction can be gained by making what they conceive to be a contribution to the betterment of other individuals and to the improvement of the opportunities and the environment to be enjoyed by future generations. In addition to these highly subjective satisfactions, the individual who closely identifies his interest with the

broader community interest may be prompted to participate in economic matters such as tax and expenditure policy, zoning and community planning even when such decisions adversely affect his economic well-being and the amenities of his life. Participation may also provide some relief and variety to the routine of one's life. As one participant phrased it "highly rewarding, and interesting—not to say exciting."<sup>3</sup>

Beyond these psychological, highly personal gains, there are economic, political and social gains which may be sought by at least some of those who participate. For some, participation in a wide variety of activities will lead to improvements in business or professional position which may result in monetary gain. As a matter of fact, participation in certain kinds of organizations, such as unions, professional societies and business organizations may be an absolute prerequisite to economic opportunity.

In addition, persons whose occupations require direct personal contacts, such as insurance men, real estate brokers, and lawyers may seek membership in community organizations to widen their circle of acquaintances, to become better known, and thus to improve the potential for their business activities. Individuals may participate in cooperatives or other types of joint buying groups, or as active stockholders in corporations in order to obtain direct economic benefits. Voluntary self-help organizations, such as baby sitting groups and car pools, also fall into this category of providing direct advantages.

Individuals who seek political office find membership in social, religious, economic and political organizations a necessary stepping stone for becoming sufficiently well-known to obtain votes and for gaining some experience in the administrative problems and the decision-making processes of collectivities whose members participate on a voluntary basis. As one businessman put it, "Politics is an entirely different world from business. . . . you don't tell people in politics, you listen; team play is even more vital than it is in industry; it isn't just intelligence that counts, but the ability to take punishment and engage in give-and-take. . . . You have to earn your spurs in politics."<sup>4</sup>

Thus, to a well-trained business or professional person used to running his affairs in a tight shop, the sometimes cumbersome, subtle and even devious methods of decision-making engaged in by voluntary participants necessitate some reorientation of thought and action. Very few successful

<sup>3</sup> Fenn, Gruenwald and Katz, *Business Decision Making and Government Policy* (New York: Prentice-Hall, Inc., 1966) p. 289.

<sup>4</sup> *Ibid.*, p. 290

politicians have avoided learning these hard facts along the way. No doubt this explains why citizens whose major activities are not geared to this kind of loosely-organized, volatile activity—doctors, school teachers and corporation executives—find the process of political participation so frustrating that they refuse to be involved or if pulled in, tend to disengage themselves after a short span of time.

For a citizen who is a member of an ethnic or racial minority, it may take even more courage to jump the boundaries into the unfamiliar world of political participation. John Stuart Mill, although commenting unfavorably about "passive types of characters" who accept authoritarian government, recognized that some persons may not be able to take the emotional strain of political participation, whereas "the active self-helping type" will prefer a government of the masses. And further that "the maximum of the invigorating effect of freedom upon the character is only obtained when the person acted on either is, or is looking forward to becoming, a citizen as fully privileged as any other." Mill also has an implied notion of the necessary balance between the costs and gains of participation in his statement "that the participation should everywhere be as great as the general degree of improvement of the community will allow."<sup>5</sup>

Social participation may involve all the above-mentioned gains to the individual—a sense of personal satisfaction, an accomplishment of a civic duty, economic or political gains. Or it may involve the attainment of status in the community which for many individuals is an important measure of personal achievement. Or it may serve as a means of providing pleasurable, leisure-time activities in a friendly atmosphere. Women's clubs, country clubs, hobby groups, luncheon clubs, civic groups and fraternal organizations are examples of these kinds of social participation. Thus, we can observe some of the objective and subjective gains of participation which enter the individual calculus, the factors which make up the plus column in this complex decision. However, the individual also calculates a minus column containing the factors which represent the private costs of participation.

All collective activity involves private costs. To assume that a person will voluntarily choose to involve himself in a collective activity implies that he has balanced the advantages and disadvantages and has selected participation in certain activities over alternative opportunities. If some

<sup>5</sup> John Stuart Mill, *Utilitarianism; On Liberty; and Representative Government* (New York: E. P. Dutton and Co., Inc., n.d.) pp. 287-92.

persons are not participating as much as seems desirable, it must mean that the costs outweigh the gains. (Barriers to participation faced by various minority groups would constitute a part of the individual cost framework.) If there is concern about the level or the mix of participation, the available mechanisms must involve high costs and/or weak incentives to certain individuals and groups in our society.

All collective activity involves decision-making costs, the time and effort required to reach a decision. In addition, there are also external costs to participation, the possibility of having to accept an unfavorable decision or of suffering adverse consequences as a result of the act of participation. The homogeneity of the group, the size of the group and the decision rules will affect both decision-making costs and external costs. At any rate, the potential return to the individual available within the mechanism used for the collective activity must be sufficiently attractive to overcome both kinds of costs. Otherwise, he will not participate.

The attitudes of business firms on participation by their employees in political or community affairs have broadened in recent years. In the past, employees were not allowed time off to engage in community projects, nor encouraged to take on such activities even on their own time. However, more recently, business firms have recognized the value of good community relations and may even suggest that executives participate.

The major types of participation engaged in by top business executives and other professional people in a community are in what might be called the "safe" or low-cost areas. Nonpartisan activities, such as serving with the Red Cross, the United Fund, the Boys Clubs, or as directors of local banks, or on boards of charitable or religious organizations or nonpartisan citizen's advisory groups, all serve to attract the best business and professional talent available. But what about more rough and tumble partisan political participation?

In spite of the declared intentions of some business firms to encourage political participation, most business executives are not completely secure in the attitudes of their superiors. They cannot be completely certain that results of their actions in so far as their employers are concerned will not prove to be costly to them. One executive who became involved in a hotly contested local political problem said that it was obvious that his employers were not pleased. Since he was new with the company, his activities were not closely associated with the company name, but still his employers seemed chilly to his political activities.<sup>9</sup>

<sup>9</sup> Fenn, Gruenwald and Katz, *op. cit.*, p. 289.

With the possibility of subtle, if not overt disapproval from their superiors in the office, few upward bound executives will risk participation in the "unsafe" areas. Instead, they can accomplish the objectives of serving the community, contributing their skills to community projects, and attaining a position of community leadership by participating in the "safe" activities cited above. This is probably the best explanation of why locally elected officials or aggressive political partisans are frequently self-employed, local small businessmen or private practice lawyers and why only rarely are they corporate executives, corporate lawyers, university professors, or others in similarly vulnerable positions.

What other costs are associated with political participation—or for that matter any kind of participation which involves drastic economic or social change? Anyone who has ever been involved in a hotly contested issue knows the non-economic risks all too well. These may include the loss of social status in the community, the personal harassment that may extend to one's wife and children, the loss of friends, even the possible loss of one's perspective and emotional stability. There is so much evidence of the high costs borne by some individuals who fought for causes that it can not be taken lightly. Thus, for everyone there are safe and unsafe types of participation. Unfortunately, the kind of participation which the individual chooses may have almost no relation to where his talents might be most useful to the decision-making process or to where the benefits to society resulting from his participation would be greatest.

A concrete example of the gains and costs balance can be found in the Community Action Program. The difficulty in obtaining participation of low income persons indicates that the gains to the poor were insufficient to cover the additional costs to them of participating in a broadbased community group. There is ample evidence that broad programs to alleviate poverty provide no specific incentive, no individual gain to the poor person. There is even evidence that poverty as a social problem is of greater concern to the middle class than to the poor; this may explain the high levels of participation of middle-class persons, both Black and White, in community action boards.

What are the costs to the poor of participating in a community action organization? They include the time and effort of getting to meetings, of engaging in lengthy, even hostile discussion, of trying to compete with citizens who are better educated and who have different value standards. These, of course, were costly to the non-poor as well. But the poor, in addition, also faced the external costs of aggressive bargaining and the

loss of what seemed to be an implied property right, the control of the program and a possible foothold in the power structure.

Power to control the program, or at least to have opinions acted on in a meaningful way, would probably have been the only gain sufficient to maintain the initial participation of the Black poor. However, neither this incentive nor any of the others provided by the programs had much appeal to the White poor who faced the possibility of being overshadowed by the Blacks in the group. This possibility was far too costly to the low-income White to attract his participation in a racially mixed group. Thus, the low income person faces not only the types of decision-making costs associated with any collective activity, but also the very real external costs that may result from active involvement in local affairs. Not the least of these may be the loss of a job or the chance for economic advancement. And the poor person is not the only one to face these potential costs. Almost every individual is to some extent economically dependent. The greater an individual's dependence on the acceptance of the community or the approval of his employer, the more he will fear aggressive participation.

#### IV

##### *Interrelationship of Collective and Private Aspects*

THE "COSTS-AND-GAINS" FRAMEWORK described above provides a useful device for isolating various components of the problem. If the individual calculates on the basis of private costs-and-gains, the level of participation achieved will depend on the outcome of this calculation. On the other hand, the policy which eventuates should reflect a broader cost-and-gains comparison, involving those purely collective values that may not enter into the calculus of individuals.

For example, if a particular decision involves nothing more than a direct transfer of income from individual A to individual B, it is reasonable to assume that both will be active participants. On the other hand, if the transfer is from individual A to the local general fund, it seems likely that only individual A will actively participate in spite of the fact that B will receive benefits, in the form, say, of a reduced tax bill or expanded public services. In the case of the direct transfer more participation can be expected than in the case of the indirect transfer although the amounts in resources may be the same. This consideration suggests that improved information concerning the implications of public decisions to all citizens would encourage a greater degree of participation.

The expert, the "peoples advocate" and the news media have an important influence in determining the level of participation since they may provide information that will alter the individual's costs-and-gains calculation. Nor can the role of education be overstressed. As individual horizons broaden and as the individual is exposed to more information and attains greater understanding of the functioning of the system, matters which seem to have only tangential significance to the poorly informed or poorly educated individual take on a deeper personal significance.

A simple illustration may clarify the relationship between private and collective costs and benefits and the effect of this relationship on the level of participation. Suppose a city commission is considering a zoning ordinance which will affect two groups of citizens. The total benefits and total costs will be viewed differently by each group depending on (a) the differential distribution of the private benefits between the two groups and (b) differential valuations of the purely collective benefits which accrue to both groups.

To simplify the illustration suppose that the general or collective benefits are evaluated identically by the two groups and are of such a nature as not to induce participation. Thus, the two groups will respond to the stimulus of a private cost-and-gains calculation. Using the benefits and costs shown in Table 1, the legislation promises Group A a net private gain equal to 6 units. To garner these 6 units of net private benefit, Group A must actively participate and this participation is not without cost in time, effort, money and frustration.

Table 1  
HYPOTHETICAL BENEFITS/COSTS COMPARISON

	Total <sup>a</sup>		Collective <sup>b</sup>		Private <sup>c</sup>		Net costs of	
	Benefits	Costs	Benefits	Costs	Benefits	Costs	Net	Participation <sup>d</sup>
Group A	16	14	8	12	8	2	6	1
Group B	10	14	8	12	2	2	0	1

a. Sum of collective and private costs and benefits excluding net costs of participation.

b. Purely collective benefit that accrues to both groups, but which does not elicit participation.

c. Benefits and costs accruing exclusively to each group and which do elicit participation.

d. Net of costs and benefits associated purely with participation.

If the net cost of participation for Group A is 1 unit, their private calculation yields a net gain of 5 which would lead them to participate

and support the measure. On the other hand, there are no net private benefits accruing to Group B and this group will not be willing to undergo the 1 unit net cost of participation. Assuming that the issue is decided on the basis of the desires of those who participate, the ordinance will pass with A's support and with no opposition from B. But it is not a good ordinance in terms of the collective component and in this particular case, no participation may have led to a better solution. To expect B to incur costs of participation in order to prevent passage is not economic, at least from the point-of-view of B. It should be emphasized that costs and benefits in this illustration include much more than measurable money costs. The net costs of participation include the sheer pleasure of participation as well as the external and decision costs and the frustration of participation.

If individuals participate on the basis of such essentially private calculations, there is no assurance that increased participation will lead to a superior solution. Returning to the example, if individuals were completely community-minded or were able in some way to blot out the private magnitudes, participation would develop along the lines suggested by the collective magnitudes and the measure would be defeated. If the individuals considered all benefits, private and collective, both would participate and, in this example, a stalemate would ensue with A voting for and B against.

Which of these magnitudes do individuals consider? Assuming narrow self-interest, they consider only the private magnitudes. Assuming a community-mindedness with no consideration of self-interest, they will consider the social or collective benefits and costs. Actually, the correct criterion is total benefits both private and collective. For decisions which have no private benefit, participation can only be achieved if individuals are motivated by a community orientation. And even this motivation must be strong enough to overcome the private costs of participation. For decisions which have a private component, participation will develop to the extent that private benefits exceed private costs.

If private and social components come in the same proportion for all segments of the citizenry, participation in the light of private calculations will lead to optimal results. Under certain circumstances, a direct subsidy to some participants may seem appropriate. It should be emphasized that the categories described as social or collective represent costs and benefits that accrue to individuals, but in a manner that does not elicit participation. If the group is small, the proportion of benefits and costs which would be placed in the private column would be greater and, if this were the

only consideration, participation would increase and superior decisions would be forthcoming.

Similarly, the identification of the social gain or loss with the private interest will lead to superior performance. When the individual ceases to ask for whom the bell tolls, he will behave as though it tolls for him. Only when the individual has adequate education and information and when he senses a vital personal stake in the viability of his society and in the quality of his environment will participation win over the TV set.

In structuring programs with participatory features, it must be remembered that different groups react to different stimuli. Social responsibility or even abstract self-interest which may appeal to middle-class Americans may be no substitute for a tangible, direct and obvious payoff for the poorly educated and poverty-stricken segment of the community.

The length of an individual's time horizon or perspective also has a bearing on the level and type of participation. The impact of a community decision on the welfare of the individual will frequently come in an uneven stream over a period of months or years. Different persons will consider different fractions of the total stream, depending on whether they have a short or a long view. These differences in perspective will lead to a distortion in the mix of community participation, a relative underrepresentation of those who view their interest in a more short-run perspective.

The factors which determine the length of the individual's time horizon are many and varied. For example, persons with a large fixed stake in the form of a real estate investment will have a longer view than those who are not tied to the long-run through property ownership. A well-educated person will probably have a longer view than a poorly educated one. A person on an annual salary may have a longer view than one paid on an hourly basis or one in a job which offers only short-term employment.

Thus, community policies are likely to be decided through "excess" participation of persons with a long-run horizon and their interests will be represented more fully than those of other groups. It would be difficult to categorize the resulting decisions as either good or bad. However, an overemphasis on long-run objectives may ignore pressing current problems. The urban renewal program which has attempted to reconstruct sections of our cities may lead to a more favorable environment for all in years to come, but it has frequently ignored the presently acute housing situation of many low-income families.

On the other hand, completely expedient programs may cause us to overlook the forest for the trees. Those persons who look far into the future may identify their interest with the community in a broader sense and therefore, their view may have breadth as well as length and may give weight to the views of those persons not well represented. At any rate, it is worth noting that, to the extent that people live on a day-to-day basis, participation in community affairs will be uneven; some distortion in the mix will occur. The solution would appear to be obvious: better education, more stability in community life and greater opportunity for the attainment of a fixed stake in the community, perhaps in the form of home ownership, for those who do not participate fully in its decisions.

The preceding discussion suggests that individuals participate on the basis of an essentially private or personalized evaluation of costs and gains. These costs and gains are evaluated differently by different individuals and groups and embrace the whole spectrum of personal values ranging from narrowly economic money costs and gains, on the one hand, to highly subjective psychological and ethical values like status and social responsibility, on the other. Traditional appeals to citizens have been couched in terms of the "higher" order of values, like duty and responsibility, and have deliberately denigrated participation motivated by personal gain and loss. There is no doubt much that is sanguine in the traditional appeal; at the same time, the private costs and gains must be considered and their impact on the type and level of participation should not be overlooked. When viewed in this manner, the purely collective gains and costs associated with participation are "spillovers" that arise as a result of individualized activity.

In view of these costs and gains, can there be too much participation? The framework used in this analysis implies the possibility of an optimal amount and mix of participation in varying kinds of collective decision-making activities. The participation in riots and various other forms of disruptive activities impose high costs, monetary as well as collective with temporary if not more long-term damaging effects on the preservation of law and order and the stability of the political system. The potential dangers or real costs of a seething minority which sees violence as the only acceptable means of participation is sufficient to cause all citizens to doubt the optimality of the mechanisms currently available. The characteristics of the decision-making process must be examined with the aim of separating out those which will provide less costly, more gainful kind of participation.

## V

## Equality of Opportunity

FUNDAMENTALLY THE AIM of promoting increased participation is to attain a closer approximation to equality of political power. The creation of new organizations and boards, required to include a certain percentage of those who are not now represented, is comparable to the system of unrelated transfer payments which has, in many instances, aggravated the conditions it was designed to improve. Unfortunately, promoting political participation has similar pitfalls. Substantial economic equality cannot be achieved without fundamental changes in the economic system. By the same reasoning haphazard bits of enforced participation cannot achieve more political equality without fundamental changes in our political system.

All the disadvantages and dangers inherent in promoting absolute economic equality are clearly present if coercion is used to enforce equality of political participation, the most potent danger being the destruction of the system we are striving to improve. It is more consistent with the principles on which the American economic and political systems are based to promote equality of opportunity for economic and political participation. To do otherwise would be to abolish the freedom not to participate in those political, social or economic activities which may not be acceptable to the individual for any variety of reasons. The only real issue, then, rests with the barriers to free participation of the individual in any phase of his life—social, economic, religious, political. And the only real decision for government policy is whether the barriers are sufficiently detrimental to equality of opportunity and to the development of each individual to warrant governmental action with the power of enforcement.

Efforts during the past few years have concentrated on the removal of barriers to political participation, such as registration and voting restrictions and regulations which result in the disenfranchisement of mobile segments of the population. The next step is the attainment of equal opportunity to participate in the decision-making process of political units. However, it will take a good deal more knowledge and analysis than is now available to accomplish a meaningful increase in the level and mix of participation. Much research needs to be done on the specific objectives of increased participation and the reactions of individuals to the various institutional arrangements through which it might be achieved.

# The Disjunction of Political Science and Political Philosophy

By JOHN T. BOOKMAN

## I

THE QUEST for a "science" of politics has animated political thought since the time of Plato. Moderns share with the ancients the desire to acquire a systematic body of knowledge concerning man's political behavior. The quest, moreover, has largely been inspired by ethical considerations. Moderns and ancients agree on the great importance, if not the primacy, of politics in human affairs and on the usefulness to man of a "science" of politics. Despite this continuity, the study of politics has undergone in recent years a methodological revolution—a revolution which has given currency to a new conception of political science. Heretofore students of politics had regarded science as any systematic body of thought. Value statements and factual statements had the same claim to warranted belief. This new conception of political science, however, denies cognitive status to value statements.

The participants in the methodological revolution have named their program "behavioralism." No definitive statement of that program has been made to which all the rebels subscribe. Nevertheless, the rebels share the same views about a criterion of validity for the testing of knowledge-claims and about the conduct of inquiry for acquiring a body of systematic knowledge. Thus Professor Easton described the salient features of the revolution as follows:

In the first place, never before has there been so great a demand for self-conscious attention to empirical theory at all levels of generality—middle range as well as general—that, in principle, can be reduced to testable propositions. In the second place, as a part of this, the social sciences have been compelled to face up to the problem of locating stable units of analysis which might possibly play the role in social research that the particles of matter do in the physical sciences.<sup>1</sup>

Thus empiricism is a part of the behavioral program. This doctrine asserts that the validation of knowledge-claims is possible only by reference to experience. Statements must demonstrate their worth as explanations and descriptions of the world in tests by observation and experiment.

<sup>1</sup> David Easton, "Introduction: The Current Meaning of 'Behavioralism' in Political Science," *The Limits of Behavioralism in Political Science*, James C. Charlesworth, ed., (Philadelphia: American Academy of Political and Social Science, 1962), p. 15.

Behavioralism proposes norms not only for the validation of knowledge-claims but for the conduct of inquiry as well. Indeed, the emphasis of Professor Easton's remarks is clearly upon theory and concept formation. It is the behavioral contention that theory and concept formation ought to be the first order of business because, in the long run at least, more significant results will be achieved. Adoption of these norms throughout the discipline is the goal of the behavioral movement—a goal often expressed as the reorientation of political science toward a scientific study of politics.

The purpose of this essay is, in part, to examine the behavioral school's claim that its conception of political science is science. It will be argued that behavioralism has adequately distinguished between two approaches to the study of politics, the scientific and the ethical, and that the competence of the scientific approach does not extend to value statements. It will also be argued that behavioralism compels a new conception of political philosophy—the ethical approach to the study of politics. Therefore, the essay concludes with several suggestions about the contemporary status of political philosophy.

## II

BEHAVIORALISM IMPLIES a new conception of political science. This conception creates a "criterion of demarcation" which permits us to distinguish statements of concern to science and statements not of concern to science.<sup>2</sup> The statements of science must be empirically confirmable. The proposals of those who wish to include statements which are not empirically confirmable in the class of scientific statements are then rejected.

Several observations are in order concerning the requirement of empirical confirmability. First, the requirement does not demand an inquiry into the origin of an idea, how an idea was conceived. Indeed, it does not concern that question at all. Parenthetically, imagination and intuition are as necessary in science as they are in philosophy, for example. The requirement of empirical confirmability is applied in the process of determining whether an idea about the world is a discovery. The satisfaction of this requirement does not of course validate a knowledge-claim. If a statement satisfies this requirement, it is possible to confirm or disconfirm the statement by reference to experience.

Secondly, a statement may have successfully withstood repeated tests, in which case it may be regarded as "confirmed," "corroborated," or

<sup>2</sup> The phrase is Popper's in Karl R. Popper, *The Logic of Scientific Discovery* (New York: Basic Books, 1959), p. 34.

"scientifically accepted." Confirmation is, however, not synonymous with truth.<sup>3</sup> "Truth" is customarily used as a time-independent term. What is true today was true yesterday and will be true tomorrow. A "confirmed" statement, as distinguished from a "true" statement, is held only provisionally. The possibility always exists that counterevidence will be adduced. Thus no claim of truth can be made for such statements although some may be true—science simply does not yield perfect knowledge.

Thirdly, the possibility of test must exist; that is, we must be able to specify those observations which would lead us to accept a statement which purports to describe or explain the world and those observations which would lead us to reject that statement. Reichenbach distinguishes three kinds of possibility: technical, logical and physical.<sup>4</sup> Technical possibility requires that it be within the practical competence of science to carry out the proposed method of test; that is, to create the opportunity for the making of those observations which would lead us to accept or reject the statement in question. Logical possibility requires that the statement in question be neither tautologous nor inconsistent; that is, it must not be true or false on the basis of its form alone.<sup>5</sup> Tautologous statements—for example, the United States is now a member of NATO or is not *now* a member of NATO—cannot be disconfirmed by any observation. Inconsistent statements—for example, the United States is now a member of NATO and is not now a member—can be disconfirmed by all observations. Physical possibility requires that the statement in question not be metaphysical; that is, the proposed method of test not violate any "laws" of nature—in the sense of regularities in nature. Science of course has only imperfect knowledge of the laws of nature.<sup>6</sup> Therefore, a proposed method of test may lead to the discovery of some heretofore unknown "law" of nature. If, however, the proposed method of test is found to violate the "laws" of nature, the statement in question is metaphysical. Obviously, all three conditions must be satisfied if science is to validate the knowledge-claim raised by any statement. Only

<sup>3</sup> Rudolf Carnap, "Truth and Confirmation," *Readings in Philosophical Analysis*, Herbert Feigl and Wilfrid Sellars, eds., (New York: Appleton Century-Crofts, 1949), pp. 52-84.

<sup>4</sup> Hans Reichenbach, *Experience and Prediction* (Chicago: Phoenix Books, 1961), pp. 38-41.

<sup>5</sup> Rudolf Carnap, *Introduction to Symbolic Logic and Its Applications*, trans. by William H. Meyer and John Wilkinson (New York: Dover, 1958), p. 15; L.P.C. Cuninghame, "Contradictory Assertions Convey Infinite Information," *Analysis*, Vol. 23 (January, 1963), p. 72; and Popper, *Scientific Discovery*, *op. cit.*, pp. 90-92.

<sup>6</sup> Moritz Schlick, "Meaning and Verification," *Readings in Philosophical Analysis*, *op. cit.*, pp. 152-54.

those statements which have successfully withstood tests can be said to represent the world, to be valid empirically. It is sufficient, however, for empirical confirmability (or empirical testability in principle) if a statement satisfies the conditions of logical and physical possibility.

Fourthly, the requirement does not confine science to a "brute" empiricism; that is, to a mere collection of the "facts" or a mere description of what is given directly by experience. The achievement of the natural sciences has been the formulation of explanations which are empirically testable. These explanations are found in theories from which empirically testable statements can be deduced and tested, given initial conditions. Scientific theories, moreover, often refer to that which is not observable—for example, the electron. However, unlike the unobservables of classical philosophy—essences—the unobservables of modern natural science are given empirical meaning.<sup>7</sup> Statements in which those unobservables appear can be disconfirmed.

Only factual statements—that is, statements which are empirically confirmable—are regarded as belonging to science, as scientifically meaningful. Therefore, value statements—that is, statements of principles held to be intrinsically good or right and statements which prescribe or evaluate on the basis of such principles—are excluded from that body of statements of interest to science. In the case of value statements, we cannot specify those observations which would lead us to accept such a statement and those observations which would lead us to reject such a statement. But this is precisely what is meant by empirical confirmability.

Moreover, factual statements do not imply value statements. Unless a value statement appears among the premises, any inference from factual statements to a value statement is fallacious. If a value statement is introduced as a premise, the conclusion itself becomes a value statement for which no scientific authority can be claimed. The fallacy of inferring what ought to be from what is was first noted by Hume. Its identification has become a commonplace in textbooks of logic. There have been several recent attempts to span this "logical gulf" between fact and value.<sup>8</sup> None seems to have been successful.<sup>9</sup> As a consequence of the fact-value dis-

<sup>7</sup> Carl G. Hempel, *Fundamentals of Concept Formation in Empirical Science* (Chicago: University of Chicago Press, 1952), pp. 20–49.

<sup>8</sup> John R. Searle, "How to Derive 'Ought' from 'Is,'" *Philosophical Review*, Vol. 73 (January, 1964), pp. 43–58; and Max Black, "The Gap Between 'Is' and 'Should,'" *Philosophical Review*, Vol. 73 (April, 1964), pp. 165–81.

<sup>9</sup> See the criticism in *Philosophical Review*, Vol. 73 (October, 1964), pp. 512–16; and in *Analysis*, Vol. 25 (December, 1964), pp. 25–41; *Analysis*, Vol. 25 (April, 1965), pp. 179–81; *Analysis*, Vol. 26 (January, 1966), pp. 104–10.

tion and the absence of any relationship of implication between the realms of fact and value, value statements have no cognitive status in the science of the behavioralists.

Science is confined in its determination of the value of something by the requirement of empirical confirmability. Therefore, a scientific study of politics can determine the value of something in only two respects. It can determine the value which some group or individual places on something. For example, does the John Birch Society place a higher value on national security or freedom of speech? The answer to this question is a description of the relative place of those values in that group's hierarchy of values. A scientific study of politics can also determine the value of something for the realization of an end which is held to be of higher or intrinsic value. If someone, for example, places a high value on popular participation in the election of public officials and wishes to increase such participation in the United States, he might inquire as to the value of holding elections for all public officials at the same time. The scientific student of politics can appropriately evaluate this suggested innovation as a means to achieve the desired end.

### III

THE BEHAVIORAL CONCEPTION of political science described above and the concomitant doctrine of "scientific value relativism" have produced the disjunction of political philosophy and political science.<sup>10</sup> This disjunction rests upon a difference in the method by which knowledge-claims are validated and, consequently, in what the political philosopher and the political scientist call "knowledge." The political philosopher subjects knowledge-claims to his ethical consciousness of social reality. The political scientist subjects knowledge-claims to test by observation and experiment. The method of political philosophy yields statements which evaluate human behavior. The empirical method of political science yields statements which describe human behavior. One obvious difference then in the knowledge yielded by these two approaches to the study of politics is the non-evaluative character of the one and the evaluative character of the other. But if the empirical knowledge which is yielded by political science were distinguishable from the knowledge yielded by political philosophy only by its non-evaluative character, then the behavioral insistence that only the empirical method is "scientific" would be no more than an attempt to appropriate for political science the honorific connota-

<sup>10</sup> The phrase is Brecht's in Arnold Brecht, *Political Theory* (Princeton: Princeton University Press, 1959); see "Excursus on the Term 'Relativism'," pp. 256-60.

tions of that term. Both political philosophy and political science claim that they possess knowledge. Empirical knowledge is, however, characterized by still another quality. It is objective. This objectivity has two aspects.

The objectivity of empirical knowledge consists in part in its intersubjective testability. Students of politics may strive to eliminate manifestations of personal and cultural bias in their work. These efforts may even go far toward eliminating such bias. Nevertheless, however scrupulous the student, there is no assurance that personal effort will be sufficient to eliminate bias. But the objectivity of empirical knowledge is not protected solely by individual will. "The term *intersubjective* stresses the social nature of the scientific enterprise."<sup>11</sup> Intersubjective testability means that empirical knowledge is capable of test by any person with sufficient intelligence and technical equipment to understand the symbols employed and to perform the necessary operations in order to confirm or disconfirm a statement. Not just privileged persons but everyone, therefore, has access to empirical knowledge.

The objectivity of empirical knowledge has another aspect. As noted above, the statements of science are held only provisionally. The knowledge-claims of science must be empirically confirmable, and, therefore, the possibility of disconfirmation always remains. Therefore, the decision to accept some statement of science as sufficiently confirmed as to constitute knowledge is in part a matter of convention. Science does not prescribe the sufficient grounds for the acceptance of some empirically confirmable statement as knowledge; it does not say, for example, how many confirming instances are sufficient for acceptance. The decision, however, is not entirely conventional. Let us distinguish two elements in a scientific communication—the evidence and the conclusions.<sup>12</sup> The conclusions consist of knowledge-claims; that is, the events observed and described are truly facts and the hypotheses advanced are truly "laws." The evidence consists of the observations made and the conditions (environmental circumstances, techniques, etc.) under which those observations were made. It is the evidence which permits the recipient to judge the validity of the knowledge-claims. And it is the evidence which constitutes the objective consideration in a decision to accept some knowledge-claim as knowledge.

Now, is the knowledge yielded by the method of political philosophy also objective? Certainly many political philosophers have claimed that

<sup>11</sup> Herbert Feigl, "The Scientific Outlook: Naturalism and Humanism," *Readings in the Philosophy of Science*, Herbert Feigl and May Brodbeck, eds., (New York: Appleton-Century-Crofts, 1953), p. 11.

<sup>12</sup> Brecht, *Political Theory*, *op. cit.*, pp. 113–16.

there is an "objective" standard by which we can evaluate human behavior. In political philosophy, of course, the term "objective" has often been used in an ontological sense. But whether there is or is not an ethical standard which exists independently of its apprehension of human intelligence, the relevant question here is—can it be discovered by everyone? And there is the difficulty. Political philosophers have claimed "objectivity" for a variety of views. But political philosophy suggests no means whereby those who believe in different standards can subject their views to test in order to discover which, if any, of those views is the one "objective" view.

#### IV

POLITICAL PHILOSOPHERS cannot claim objectivity in the epistemological sense for value statement. One can of course continue to claim that an ethical standard is an ultimate constituent of reality; science cannot demonstrate otherwise since it cannot address itself to metaphysical questions. Nevertheless, in making such a claim, the political philosopher should recognize that his claim lends no validity to his specification of what that ethical standard is—however persuasive it may be in fostering belief.

Although we may join in the behaviorist's denial of cognitive status to value statements, we need not conclude that political philosophy is a worthless enterprise.<sup>13</sup> There are, for example, many analytical tasks which the political philosopher might perform. Let us however leave these aside. What is at issue here is prescription and evaluation. Unfortunately some contemporary defenders of political philosophy have compromised the case for that enterprise by focusing attention on what Professor Edel has called the "argument of the stubborn man;" namely, my ethical standard is right and that is all there is to it.<sup>14</sup> These defenders of political philosophy wish to assert that some such arguments are objectively false—for example, the Nazis' assertion that the Aryan race is superior. But they cannot do so except in a metaphysical sense. This seems, however, an inappropriate way to combat the dogmatism of the stubborn man since the implication that there is an ethical standard which can be known only by some itself permits dogmatism. Furthermore, this concern seems misplaced since we are not confronted with such arguments

<sup>13</sup> I do not wish to imply that behaviorists, either all or most, do so regard political philosophy.

<sup>14</sup> Professor Edel describes the phenomenon and its significance for ethical theory in Abraham Edel, *Ethical Judgement: The Use of Science in Ethics* (Glencoe, Ill.: The Free Press, 1955), pp. 70–91. Some behaviorists have also given almost exclusive attention to such arguments. A scientific study of politics cannot demonstrate that the stubborn man is wrong but, short of statement of an intrinsic value, political science can address itself to many questions involving values.

in philosophical discourse but only over the barricades. Therefore, to give political philosophy the task of "disproving" the argument of the stubborn man is to give it a task which it cannot and need not discharge.

Political philosophy, then, is worthwhile but not for this reason. It is worthwhile because men have found it needful. Men, or at least some men, have found need for the kind of view of man and his condition expressed in political philosophies—a view informed by prescription and evaluation as well as knowledge.

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### *The Uses of the Sea*

AT THE UNITED NATIONS an ad hoc committee is studying the complex and vital issue of the peaceful uses of the seabed and ocean floor beyond the limits of national jurisdiction. Both the U.S. and the Soviet Governments have proposed that the Eighteen-Nation Disarmament Committee open talks on the subject of arms limitation in this area.

U.S. Representative David H. Popper announced to the committee that in the interests of an expanded program of international cooperation in marine science the United States would be prepared to make Rose Island, an uninhabited coral atoll in the South Pacific Ocean owned by the United States, available for scientific purposes as a part of a marine preserve.

As envisaged by the United States, the plan for an international decade of ocean exploration will involve major contributions of equal proportions from the United States and the Soviet Union. The bulk of the remainder would come from the other major maritime nations.

The projects undertaken under such a program might fall into the following separate areas:

—*Exploration of living resources of the sea* to help save millions of people from needless hunger.

—*Exploration of the ocean floor* to provide information on the nature, availability, and distribution of mineral resources.

—*Exploration of ocean processes* to add to our knowledge of the motion of the sea and its dynamics; the interaction of the air and the sea; and the evolutionary processes of ocean basins.

—*Assistance to developing nations.* Such assistance could involve mapping of selected areas of the continental shelf and surveys of resources. We would hope that through a sharing of effort, developing countries would soon be able to construct national programs of their own in the marine sciences. [From the U.S. Department of State.]

# Tax-Induced Slow Turnover of Capital, I

By MASON GAFFNEY\*

"Ye build! ye build! but  
ye enter not in."

. . . LYDIA HUNTLEY SIGOURNEY

## I

### Introduction

PRESENT DOLLARS are heavy dollars; future dollars are light dollars. The effort of taxpayers to retard tax liabilities and advance tax write-offs follows as the night the day, and economists understand the rudiments of this game: taxes deferred are taxes denied.

The economics profession has lagged in developing capital theory and more so in incorporating it in its teachings. It is catching up, but the particular application to tax policy still lags.<sup>1</sup> This is a serious omission, since taxation has the most profound effects on the intertemporal allocation of resources and, by retarding replacement of capital, on gross investment and national income.

This study purports to help recover the lag; to develop the thesis that excise and income taxation as practiced today bias investors toward the future; to specify a modified definition of depreciation that would remove the intertemporal bias; to advance the thesis that tax neutrality requires that we tax appreciation and deduct depreciation at the time they accrue; and that these reforms would convert the income tax into the property tax.

The early enthusiasts of income taxation believed that the tax would not much bias resource allocation because that use of a resource which yields the highest returns before taxes still yields the highest return after taxes,

\* With mathematical appendices by Michèle Consigny. The writer thanks the departments of economics at the University of Wisconsin-Milwaukee and the Universities of California at Los Angeles and Santa Barbara, and the real estate research department at the University of California at Berkeley, for criticism offered at seminars on the subject of this paper; and Michèle Consigny for criticism and assistance. (A short version of this article appeared under the same title in *Western Economic Journal*, Vol. 5, No. 4 (September, 1967), pp. 308-23.

<sup>1</sup> The lag does not suggest complete neglect. The timing of tax liability and write-off were matters whose importance was evident to Irving Fisher, with his proposal for an expenditures tax; William Vickrey [38, 7, 137-38]; Henry Simons, who emphasized the desirability of taxing asset appreciation currently rather than waiting for realization; Harold Hotelling, who advocated defining depletion as the drop in value of a mine due to use, a lesser figure than the spot value of minerals severed [18, 170]; Richard Musgrave, who seeks a basis for a neutral depreciation schedule [23, 338-44]. But none of these dwelt on the question long enough to integrate the parts into a general theory of the subject, or arrive at operational results.

all returns being reduced pro rata. L. C. Gray applied this principle to one instance of intertemporal allocation, mineral conservation [15]. He noted that a mineral should be extracted when the percentage growth rate of its net value falls below the interest rate; and that that percentage growth rate was the same after taxes as before.<sup>2</sup>

From that he concluded that a tax on land income could be free of intertemporal bias. We have no major quarrel with that finding, although much depends on how the tax is announced. But Gray's example is quite a special case, where investment at time zero consists of foregone gain on early realization of a rent. We will see below (Section V) that such passive investments automatically receive unusual tax treatment—they are "expensed"—written off as current expenses—implicitly.<sup>3</sup>

In the more general case, early costs are written off over time or at maturity. Then income taxation loses its intertemporal neutrality. Still Gray's demonstration holds forth the hope that we might devise a tax system free of such bias. This paper has both aims: to demonstrate that prevailing tax methods bias investors toward longevity; and to show how we may modify the income tax to remove the bias.

The importance of the subject for micro-economics is self-evident: a bias towards longevity keeps sovereign consumers from getting what they want. It ties up scarce capital in trees or premature utility extensions yielding society, say, 4 per cent yearly, while small merchants and manufacturers cannot finance inventories that would yield, say, 15 per cent, and would also sharpen competition.<sup>4</sup>

The importance for macro-economics is even greater. Almost everyone has learned to eschew the "broken-window fallacy" (that even wanton destruction is healthy because the replacement employs people); and hardly anyone endorses planned obsolescence as a means of increasing employment. Economists do not like macro-economic benefits that violate micro-economic principles. And, although we have accepted many wastes in the name of full employment, we cherish a particular distaste for artificial acceleration of turnover and replacement.

$$2 \frac{R_n(1-t)}{R_0(1-t)} = \frac{R_n}{R_0} = (1+i)^n, \text{ when } R = \text{net revenue of mineral severance, with all costs assumed current (a very limiting assumption).}$$

<sup>3</sup> Because the resource whose gains are foregone incurs no tax liability in the year when committed to a long term investment. To anticipate Section V, expensing is tantamount to tax exemption, which accounts for the seeming absence of bias. It is not the rent which is exempted, but interest on deferral of rent.

<sup>4</sup> Small businessmen with weak credit ratings are on the whole the more competitive firms in the economy. Because of their weak credit they tend to specialize in enterprises where the capital turns over faster, and the marginal rate of return is higher. These more competitive firms are the ones our tax system hits harder.

This is not to suggest accelerating replacement by any artificial means that would impose micro-economic wastes. But what if there is a large institutional bias that artificially retards replacement? We would expect economists to oppose it for both micro- and macro-economic reasons. We will show that excise and income taxation do just that. The macro losses of slow replacement were long ago outlined by Böhm-Bawerk and Wicksell,<sup>5</sup> and more recently restated by Domar, Dorfman, Terborgh, Brems, and others,<sup>6</sup> and we will not labor them here. The micro losses will be obvious in our exposition.

The importance of our topic to the distribution of wealth and the allocation of resources is manifest in the fact that higher income groups take higher shares of their income in the form of capital gains, a fact of modern life documented in many recent studies.<sup>7</sup> The taxpayer gains from the lower tax rate on capital gains, of course. But even at equal rates he would gain by the deferment of tax liability, and this second benefit often outweighs the first and affords the paramount motive for arranging one's affairs so as to convert ordinary income into capital gains.

To the extent that taxpayers can convert ordinary to gains income by mere paper manipulations, the effect is only distributive, an important matter in itself. But there are few paper manipulations without their real counterparts, and the general effect of this tax-avoidance maneuver is to reallocate real capital. Investments that pay out fast lose their lustre relative to alternatives that pay out slower. Tax bias makes pie in the sky look better than pie on the plate. Capital moves into growth situations; submarginal utility extensions to capture remote future markets; minerals exploration far in advance of need; premature research; building up farms by current losses for future gains; elbowing for Pacific airline routes that might yield returns some day; purchase and development of exurban land for appreciation; tree farms; institutional advertising; grandiose visionary

<sup>5</sup> "... any given total of present goods, be it large or small, is sufficient to purchase and remunerate the total supply of labor. . . . All that is required is to bring about a corresponding contraction or extension of the production period." [4, 354].

"If . . . a shorter period of production . . . is adopted, . . . the capital which was before insufficient is now able to give employment to all workers." [42, 127. See also 131-33, 145-46, *et passim*.] See also Wicksell's *Lectures on Political Economy* [41, 172-78].

<sup>6</sup> See Domar, *Essays in the Theory of Economic Growth* [9, 33]; Dorfman, "Waiting and the Period of Production" [11]; Terborgh, *Bogey of Economic Maturity* [37]; and Brems, *Output, Employment, Capital, and Growth* [5]. Other economists writing on the macroeconomic importance of replacement frequency have been Senior, Ricardo, Von Thünen, Jevons, Barone, Åkerman, Spiethoff, and Hayek.

<sup>7</sup> See Internal Revenue Service, study of 1962 tax returns, reported in *Business Week*, Feb. 11, 1967, p. 90.

enterprises of all kinds. Meantime, capital neglects more pressing immediate and intermediate needs and opportunities: operation and maintenance of central buildings and rental property; adequate inventories; tools and machinery; developing and extracting known mineral reserves; rolling stock; poultry and hogs (which mature faster than cattle); vegetables (which mature faster than fruit); prosaic "fillers" needed to complement the visionary "builder" investments in every industry. Those are faults of which we love to accuse the Soviets; but before picking the mote from our neighbor's eye, let us check with our own ophthalmologist.

The bias is to neglect immediate opportunities in favor of Boulding's "benefits hereafter"<sup>8</sup> with the associated benefit of taxes hereafter. A review of the many specific maneuvers by which corporations and people of means avoid taxes suggests that the allocation of capital has become downright dominated by the motive to defer tax liability—a motive which our mathematics will demonstrate, and which is not hard to credit in an age of tax rates at 50 per cent and more.

In an age of such high tax rates, again, we may dismiss the old red herring that investors are not rational enough to follow the thinking involved in maximizing their after-tax returns, or even in distinguishing pre- and post-tax returns. Surely there is great irrationality to be observed on every hand; and Ezra Solomon has recently shown that conventional accounting practice usually misstates true rates of return.<sup>9</sup> At the same time, rates of interest on tax-exempt municipal bonds are advertised in the daily press specified to four significant figures, suggesting that someone calculates after-tax returns carefully. This generation of lawyers and accountants has made a major profession of "tax engineering," and one may take their growth as *prima facie* evidence that tax avoidance has become a major determinant of investment decisions.

On the other extreme, some mathematical readers may regard our argument as too obvious to labor. If we do draw that response, we will congratulate ourselves on a successful conversion and take some credit for having made it so obvious. As indicated at the outset, Professors Simons,

<sup>8</sup> If memory serves: "In modern industry, research  
Has become a kind of church  
Where rubber-aproned acolytes  
Perform the ceremonial rites  
And firms spend funds they do not hafter  
In hope of benefits hereafter."—K. BOULDING.

<sup>9</sup> Solomon's "Return on Investment: The Relation of Book Yield to True Yield" [30]. Among other things, he shows that conventional practice usually overstates the return on longer maturities relative to short. So if irrationality does prevail here, it may reinforce the bias to longevity.

Fisher, Hotelling, Vickrey, Musgrave and other have all anticipated parts of our thesis. But the most recent of these, Professor Musgrave, left the subject, which he treats by an arithmetic example and a trial-and-error approach, with the observations that, "... the problem does not lend itself to a simple mathematical solution. . . ." [23, 340] and "... the task of formulating a truly neutral-depreciation policy becomes exceedingly complex." [23, 343]. It is this exceeding complexity which we believe we have overcome. Another prominent tax economist, Professor E. Cary Brown, has reached a conclusion the reverse of ours, with much laying-on of hands.<sup>10</sup> On different grounds, Professor Stephen McDonald has maintained that business income taxes are biased against capital-intensive industries.<sup>11</sup>

Obviously our finding should not appear trivial to those who teach that an income tax need not deflect resources from the uses they would otherwise have: we find that it does. Our analysis will also discredit the belief that an excise tax may be neutral so long as it is general. Most important, our analysis will suggest that macro-economic policy makers need attend to the effects of tax and depreciation methods on the longevity of investments and thereby on frequency of reinvestment.

For introductory expository purposes, it is useful to divide real assets into four classes with different major traits, which we will treat in order. There are:

1. *Appreciating assets*, like trees or cattle, whose primary yield is their salvage value at maturity. These obviously benefit more than other assets from deferral of tax liability (except that most inventories, which fall in this class, have lives too short to receive any benefit in practice, or much in theory). This is the "point-input," "point-output" case.

2. *"Full salvage" or constant value assets*. This is a model case that is

<sup>10</sup> See Brown's "Business-Income Taxation and Investment" [6]. The denial is on page 529 of the reprint. Selection by Editors Musgrave and Shoup does not, of course, imply their personal endorsement of every position held by each contributor. Indeed, Professor Shoup's article in the same volume [29] might be construed to hint toward the opposite conclusion, *i.e.* the one we endorse. Inclusion does imply, however, that the work is regarded by elders of the profession as a "classic." Professor Musgrave elsewhere [23, 337, n. 1] refers to this work as "the basic article" on the subject although, again, Professor Musgrave's text on pages 340-42 of the very same work finds a bias against short investment. So his own position would seem like ours rather than Brown's.

<sup>11</sup> Stephen McDonald has maintained that business income taxes are biased against capital-intensive industries [21]. For a summary of extended subsequent debate between McDonald and several critics, see S. McDonald, "Percentage Depletion Expensing of Intangibles, and Petroleum Conservation," [22]. Professor McDonald, like ourselves, finally finds a high degree of neutrality in the long-scorned property tax. For that position see McDonald, "The Effects of Severance vs. Property Taxes on Petroleum Conservation" [20].

useful for exposition because of its analytical simplicity. It may be approximated by the milk cow. The asset costs  $C_0$  dollars at time 0; yields a regular income for  $m$  years of life; and then returns a full salvage value of  $C_m$  dollars, the same as its cost. It neither appreciates nor depreciates. It is like a time deposit from which one regularly withdraws all the interest.

3. *Depreciating assets*, like plant and equipment. These yield a regular cash flow that includes both income and return of capital. Here, the division of gross income between taxable income and capital recovery is more difficult than in the simpler cases 1 and 2; but we will expound a technique for doing so which can be applied to other assets as well, and which, applied to determine deductible depreciation, could remove much of the intertemporal bias from income taxation. Assets depreciate over time both because their life expectancy declines and because they yield less each year. The first is analytically simpler if taken alone, and, for expository clarity, on this basis we subdivide class 3 into: a. Assets yielding a constant cash flow over finite lives, and depreciating only because they approach end of life. (Anyone who has dealt in the academic flesh market will recognize this concept.) b. Assets yielding changing cash flows over finite lives. Usually the change is negative, but many assets yield undulating returns and we will ultimately frame a general formulation to cover all cases (Appendix II). Initially, however, we expound the simpler case 3a.

4. *Land*. Here there is infinite life. Partial depreciation is possible due to declining income, but appreciation is more common and may continue indefinitely. Here, as with case 1, the possibility of tax deferral is a maximum. There can be no tax bias to construct more durable land, of course, since it is not produced and its longevity comes from nature. There can occur, however, an interclass distributional benefit to owners of this asset; and within the class a special benefit to holders of appreciating land. There can also be a special incentive to investment in what Wicksell called "rent goods," *i.e.* nearly permanent land improvements like filling in shallow water sites, or damming up artificial lakes to sell lakeside lots, or grading and filling land for subdivisions. These improvements are closely associated with land. They take on some of the qualities of land itself, and often are realized on only by selling lots.

For brevity, we omit *paper assets* from the list, with the thought that these are ultimately claims to real assets, so that our list is reasonably comprehensive as a beginning. But certainly paper operations like the plow-back of corporate earnings to convert stockholder income into later capital gains, or the assignment of earnings to contingency reserves, are central

to our subject and warrant early attention. Again for brevity, we assume that our investors are self-financed and cannot deduct interest from taxable income. When interest is deductible it adds some interesting wrinkles to the analysis, but in essence it merely adds a step without changing the basics, for what is deductible to the borrower is taxable to the lender.

We assume expectations of no change in tax rates, and we ignore the progressive rate structure. It has been suggested that investors expect to move into higher brackets and so prefer present over future tax liabilities. No doubt such cases can be found. We suspect, however, that a large share of investing by individuals is done by older people nearing retirement, with the prospect of lower marginal tax rates. To resolve that question is beyond our present scope.

We assume away the possible acceptance of a lower rate of return on shorter maturities due to liquidity preference. In a perfect market that should not be a factor anyway, since longer maturities are liquid through resale or hypothecation. Our conclusions need to be refined to take account of the fact that, under taxation, the investor, to gain the benefit of tax deferral, has to avoid sale, *i.e.* is "locked in." This itself destroys any perfect market in long maturities and should make investors require a premium for loss of liquidity when they invest long. However, they can borrow on these assets, and so liquidate them without sale or tax. Perhaps the major problem to note here is that the opportunity to achieve tax avoidance by deferral tends to be invidiously reserved for the rich and creditworthy who can afford to absorb any loss of liquidity and whose loss is the least because of better credit ratings.

It is also often assumed that investors accept lower returns on shorter-lived investments because of lesser risk. We reject that assumption. It would involve transferring an observation (a questionable one at that) from the bond market, a sanitary refuge where there are no price risks, but only lenders' (credit) risks and risks of general changes in interest rates, to the firing line of real goods investments where there are a dozen more risks.

Consider the investor as the residual claimant on the product over time. The leverage on his share of the product varies inversely with the period of investment. To earn 5 per cent in one year, in a point case, the investor must sell a \$100 investment for \$105. A 5 per cent drop of selling price below his expectation wipes out his income completely. To earn 5 per cent in 56 years, he must sell for about \$1,600. A 5 per cent drop of selling price scarcely ruffles his return. It would have to drop by \$1,500, or 94 per cent to wipe out his income.

So we doubt if in pre-tax equilibrium longer investments require a risk premium any more than shorts, and for brevity we assume no premium either way.

With those preliminaries and ground rules, then, let us lay out the effect of tax avoidance on investment longevity in the four basic classes of real assets. We will first show biases within each class, and later comment on interclass bias.

(Continued)

*Resources for the Future, Inc.*  
Washington, D. C. 20036

### *Economists and Sociologists Needed*

A CONTINUING RECRUITMENT PROGRAM for persons with background in economics and sociology is being directed by New York State's Narcotic Commission to meet the demands of its expanding program of treatment and rehabilitation of drug addicts, Commissioner Lawrence W. Pierce has announced.

Qualifications for positions with the commission in this area include a bachelor's degree from an accredited college or university and a professional background in economics and sociology. Annual salaries for these positions, when they are available, range from \$7,200 to \$16,490, depending on experience and qualifications.

The program, initiated in April, 1967, by Governor Rockefeller, provides for the commitment of court-certified addicts, followed by a rehabilitation program having the broadest applications. Included in the program are medical care, group counseling, psychiatric and other rehabilitative therapy, job training and placement.

To maintain the high standards set by the commission's program, persons with formal educational training and practical experience in social work, education, psychology, sociology and law, are frequently needed to fill important civil service posts.

Information about the program and employment opportunities can be obtained by writing to the personnel director of the State Narcotic Commission at Executive Park South, Albany, N.Y. 12203. [From the Commission.]

# Financing Public Education and the Property Tax

By RICHARD W. LINDHOLM

## Introduction

THIS PAPER BRIEFLY EXPLORES the American historical background of the property tax and the financing of elementary and secondary public education. The close relationship of the two is demonstrated to have been a happenstance, but one that has had a very important effect on both the American development of primary and secondary education and the administration of the property tax. It is against this background that today's conditions are examined to establish education and property tax trends. Finally this base is utilized to develop an integrated program of education financing and policy-making.

## I

### Historical Development of Public Education Financing

THE HISTORICAL BACKGROUND of the property tax in the United States that spread throughout the nation is fairly well established. The tax was not used except as a tax on particular items until the 1820-40 period. When the national government took over the monopoly of customs collections in 1789 with the adoption of the federal constitution, the colonies, now states, began to look for substitute revenues. The levy of a tax on a list of things, just as customs duties are levied on a list of imports, was chosen. By the 1820's the list had begun to develop into a general percentage levy on the value of land and in some cases all property. From 1840 to 1860 the general *ad valorem* property tax moved from state legislation to state constitutions, and the breadth of coverage was increased.

The tax grew as a local revenue source and as a state revenue source. The tax turned out to be the revenue source relied upon by local governments after the Civil War when free universal education was introduced and a very large portion of the financing was drawn from local government units—the school districts. The later growth of government expenditure for a large area of citizen service—long distance highways for automobiles—became a major state financial obligation in the 1920's. The states—following the lead of Oregon in 1919—turned to a special excise tax on gasoline. Basic policy for highway development was to be set by the state and the revenue source to implement policy decisions was developed.

In the year 1890, the American Economic Association published *History of the New York Property Tax* by John Christopher Schwab.<sup>1</sup> The study in looking toward reform recommends a reduction in the functions of the state in the administration of the property tax. Hopefully, weaknesses apparent in state use of the property tax would be corrected, the author believed, if the tax were administered entirely by local officials and all the funds were used to finance local government services. The tax was the financial backbone of the revolutionary local education program of the United States. The states were successful in their efforts to locate other revenues for tax purposes.

State legislation and constitutional provisions of the 19th century provided for the financing of state activities by millage levies on the assessed value of properties. The values were to be determined under state laws by elected county and township officials. The states were to rely on officials of other government levels to administer a tax to provide state revenues.

Before the days of the automobile, revenue demands of the local governments expanded much more rapidly than those of the state. For example, in Ohio state taxes increased by 165 per cent between 1846 and 1859 and during the same period local taxes increased by 329 per cent.<sup>2</sup> At this early date the need for local revenues, added to the local roots of the administration, moved the property tax away from the state level toward local government. The trend continued and finally resulted in the existing situation where the general *ad valorem* property tax is a very minor source of state tax receipts.

## II

### Analysis of Historical Development

THE DEVELOPMENT of the *ad valorem* property tax as a local tax grew out of three tap roots. (1) The state reliance on local officials to administer the tax. (2) The need for local revenues to finance free public education. (3) The belief that state government expenditures could be financed with new taxes administered by state officials.

#### *Administration*

Although the states, in the past, made extensive use of property tax revenues, none of the states directly assumed the burden of administering the tax.<sup>3</sup> State laws governing assessment of property values were passed,

<sup>1</sup> J. C. Schwab, *Publications of the AER*, Vol. V, No. 5, September, 1890.

<sup>2</sup> Ernest L. Bogart, *Financial History of Ohio* (Urbana, Ill.: Univ. of Illinois Press, 1912), p. 229.

<sup>3</sup> Sumner Benson, "A History of the General Property Tax" in *The American Property Tax: Its History, Administration and Economic Impact*, George C. S. Benson, ed., (Claremont, Calif.: Claremont College's Printing Service, 1965), p. 71.

but a body of state assessors to administer the law was not a part of the legislation. The states relied on local township or in some cases county assessors, usually elected officials, to search out taxable property, place a value on it, collect taxes due, and sell properties on which taxes were delinquent. This general rule was abandoned by many states in the assessment of selected properties, *e.g.*, those of public utilities and banks. In the areas where the states did assume the responsibility for the full administration of the property tax, the performance was generally superior.

Thus the property tax which started as a state tax, with Ohio providing a considerable portion of the leadership, soon became a local tax source to support developing local governments.<sup>4</sup> However, the states retained legal control over the tax through constitutional provisions and state legislation. This continues to be rather largely the legal position of the property tax. It, of course, corresponds to the subordinate position of local governments in the state-local government relationship.

The failure of the states to take over the property tax and administer it as a state tax was an important element in the tax's drift toward where the real administration took place, the local level. Local administration has also often meant unprofessional administration.<sup>5</sup> The deep involvement of local government people with property tax administration and their ability to solve the problems of this tax made local governments hesitate to experiment with other taxes. Also, their inferior legal position *vis à vis* state governments made experimentation difficult. On the other hand, the deep involvement of local officials with the property tax, and a general lack of experience in administering other taxes, caused local government officials generally to feel that the property tax was the tax best suited to their needs. As a result, a general feeling arose among property tax practitioners that the theoretical positions developed by the academic community were sound. The consensus of the academic students was that the property tax was the revenue source best suited to local government use, and therefore the state should not collect it. A major purpose of this paper is the examination of this position.

### III

#### Education Finance

THE PROPERTY TAX as a local tax is closely tied to the provision of education as a local responsibility. Actually, education, primary through sec-

<sup>4</sup> Jens Peter Jensen, *Property Taxation in the United States* (Chicago, Ill.: Univ. of Chicago Press, 1931), p. 44 and Bogart, *op. cit.* pp. 11-12.

<sup>5</sup> Jensen, *op. cit.*, pp. 457-58.

ondary, was not considered entirely a local government responsibility in the 19th century. The federal government made land available to support local education and back in 1845 the auditor's report of the State of Illinois showed a school funds expenditure of \$282,960 of a total state expenditure of \$1,869,938.<sup>6</sup> The idea of equalization of school opportunities developed a strong thrust in the 1930's. Since then all states have developed some procedure for distributing state aid to local education administrators on the basis of relative economic ability to carry forward the normal education function—the less the relative economic ability the more the state aid. In 1929–30 some 83 per cent of public school revenues came from local government. This had fallen to around 50 per cent in the 1960's.<sup>7</sup>

Despite the federal and state governments' historical and current financial interest in financing primary and secondary education, the school district, through its property tax levy, meets a varying but large portion of the costs. Local control of primary and secondary education through such local provision of the financing exists widely and is considered to be desirable. Because the school district levy typically accounts for over 50 per cent of property tax collections, the level of this expenditure is an important element in making property taxes as high as they are.

#### IV

##### New State Revenues

BY THE 1880's the older states such as New York were busy developing state revenue sources independent of the property tax. The business corporations were the first economic institutions to be identified as independent state tax sources. Inheritances were subjected to state taxation at about the same time.<sup>8</sup> The general attitude seemed to be that the local governments' need for additional revenues should take precedence over that of state government in tapping the *ad valorem* property tax base so as to expand government revenues.

The pressures for spending between 1870 and 1914 and the closeness of the services to be provided by this spending to the local community created the appropriate environment to move the property tax toward local governments and away from the state. The changes recommended to accommodate the fiscal requirements was called "segregation." Segregation, which was first recommended in 1886 in Illinois, provided for the

<sup>6</sup> Bogart, *op. cit.*, p. 83.

<sup>7</sup> Roe L. Johns and Edgar L. Morphet, *Financing the Public Schools* (Englewood Cliffs, N. J.: Prentice-Hall, 1960), p. 115.

<sup>8</sup> J. C. Schwab, *op. cit.*, p. 91.

abandonment of the property tax as a source of state revenues. The advocates felt that state revenue needs could be met by a group of indirect taxes.

Segregation recommended separation of the tax sources used by state governments and the tax sources used by local governments. It was a policy recommendation attempting to establish between state and local governments the relationship that existed between the federal government and state governments.

The program was recommended by tax reformers as a method of improving the property tax.<sup>9</sup>

## V

### The Property Tax in the Great Depression

DURING THE LAST twenty years of the 19th century and the first twenty years of the 20th century, a basic change developed in the fiscal systems of state and local governments. The property tax was no longer to be a basic concern of the state government. The states were to develop indirect taxes and use their power of incorporation which gave them authority to tax their creatures, the corporations, to meet their revenue needs.

All of the discussions of the period assumed that the expenditures best made by state rather than local government would remain as they were at the turn of the century. It was taken for granted that the expenditures administered by each level of government would also be financed by taxes levied by that level of government. Neither the idea of grants-in-aid between state and local governments nor of the distribution of state-collected revenues to local governments for their use entered significantly into the considerations. It was assumed that primary education, the major growing expenditure, would remain firmly rooted in the local government as would road construction and maintenance. Higher education was largely supported by the private economy with the state area limited to teachers colleges and cooperation with federally-assisted land-grant colleges.

This was the situation as the American economy and society moved placidly along from 1910 to 1930, with some frivolity and violence induced by war and prohibition. Then came the sharp deflation of 1933, and the property tax frequently could not meet local expenditure requirements. The states developed retail sales taxes and increased the productivity of personal income taxes and corporation taxes to acquire funds for grants to help the financing of primary and secondary education. In 1932, 0.5 per cent of state revenues came from a general retail sales tax and in

<sup>9</sup> Robert Murray Haig, *A History of the General Property Tax in Illinois* (Urbana, Ill.: Univ. of Illinois Press, 1914), p. 227.

1956 some 23 per cent came from this source.<sup>10</sup>

The property tax, which had gradually become only a local government tax, proved in the depression 30s not to have the basic revenue stability which tax theorists had identified as one of its few good basic characteristics.<sup>11</sup> Jensen, writing in the late 1920s, took the regular collection of property taxes as being assured and discussed delinquency only as the result of economic decadence of a limited area, taxpayer carelessness, bad tax collection procedures, or unrealistic expenditure programs.<sup>12</sup> The vital importance to the performance of local government services of regular collection of the assessed amounts was recognized by Jensen and he wrote "that if a cog slips in the machinery and the assessment or the collection or both are delayed, the situation becomes extremely critical."<sup>13</sup> He did not visualize cogs being frozen through severe and continuing deflation. The types of pressures which resulted in sharp reduction of property tax collections from 1932 to 1937 were not considered in Jensen's very careful analysis of the tax.

The deflation crisis of the 1930s largely completed the elimination of the property tax as a source of state revenues. State aid to local school districts was the largely new element that developed at this time. It was introduced first in only a few states as a temporary procedure but rapidly became more widespread and turned out to be very permanent indeed.

Property tax collections for state use arose in New Jersey and Nebraska and Montana with scattered amounts in other states, largely from the application of property taxes to public utilities. It is calculated that property taxes going to state governments amount to somewhat more than 3 per cent of collections and provide states with somewhat less than 3 per cent of the revenues they collect from their own sources.<sup>14</sup>

Today the property tax is almost exclusively a local government revenue source providing some 88 per cent of the tax revenues of these governments. In Ohio the property tax became almost entirely a local tax source as early as 1902.<sup>15</sup> It is also true that local governments spend nearly half of their tax collections for education. Therefore, the support of education absorbs about one-half of the property tax collections.

<sup>10</sup> John A. Vieg, *California Local Finance* (Stanford, Cal.: Stanford Univ. Press, 1960), p. 144.

<sup>11</sup> Dick Netzer, *Economics of the Property Tax* (Washington, D. C.: The Brookings Institution, 1966), p. 7.

<sup>12</sup> Jensen, *op. cit.*, pp. 326-30.

<sup>13</sup> *Ibid.*, p. 76.

<sup>14</sup> Netzer, *op. cit.*, p. 9.

<sup>15</sup> Bogart, *op. cit.*, p. 111.

## VI

Justice of General *ad valorem* Property Tax

THE LITERATURE in public finance which attempts to justify large property tax collections because the funds collected are spent for education has sought to demonstrate that the expenditure benefits the taxpayer. The effort typically points out that the value of property increases with the productivity of the population and that this productivity is substantially increased by a good education. The benefit to property from school expenditures is of quite a different sort than that which arises from the city's employment of police and firemen. Most expenditure areas supported by property tax collections other than that for education benefit property owners directly. The result is a much more direct justification for the taxation of property, particularly property other than land.

The benefit theory of tax payment justification has come into the consideration of property taxation because tax philosophers since the days of John Stuart Mill have seen that the tax payment, to be just, must be compensated for by benefits received by the taxpayer or be levied on the basis of ability-to-pay.

The property tax could not qualify as a just tax on the basis of the relation of payment to ability-to-pay, for direct property tax payments do not vary in any regular way with personal income adjusted for costs of earning the income and family responsibilities of the income earner. Nevertheless, the property tax was collected; the tax had many good characteristics and a portion of the receipts were used for roads, fire protection, and the like. The benefit justification seemed to be appropriate. But it had to be expanded to include the indirect benefits of education when they came to absorb 50 per cent or more of the collections.

The benefit justification could not rest on the education benefits directly enjoyed by property taxpaying families with children going to the schools supported from taxes collected on the assessed values of property located within the local school district. Actually there is nearly an inverse relationship between the number of children going to school from a family and that family's property tax payments.

The indirect benefit of educating the children of families in a neighborhood undoubtedly has an economic worth. It is also true that the education of children in areas other than where real estate is owned has an economic worth to the out-state or out-district property owner and property tax taxpayer. However, it is very doubtful if this economic value of general education is peculiarly associated with real estate ownership. This point is the nub of this discussion.

If real estate does not gain in some outstanding way from general education, the justification of property tax levies for education on the basis of a benefit theory is not acceptable. It would be as just to tap any revenue source for education as real estate on the ground that the owners received this type of benefit. If the portion of property tax revenues going for education must rely on this type of benefit justification, it becomes a tax inferior to the sales or income tax. For the sales tax has the additional justification as a tax on the quantity of the fruits of the society a taxpayer has enjoyed.<sup>16</sup> The income tax has the additional justification of being paid according to ability-to-pay as measured by taxable income after permitted deductions.

## VII

### Justice of Land Value Taxation

THE JUSTICE of the *ad valorem* property tax of today is best understood when like Gaul of Caesar's time, the subject is divided into three parts: land value, structure value, and personal property value. The utilization of the personal and structure value base cannot be a concern of this analysis more than to consider now and then how the tax could be changed from its present form.

The basic justice of the taxation of land value does not rest on ability-to-pay or on some special benefits land enjoys from government expenditures. It has been demonstrated that the degree of possession of benefits and ability-to-pay enjoyed by the land owner are not sufficient to support the property tax as a major revenue raiser. For the tax to be a just tax, it must receive major support from another source. A general source exists for the portion of the property tax resting on land values, which is the portion of the property tax recommended for state administration and use later in this paper. The values of structures and personal property find justice as a tax base for they can be used as a handle to collect costs associated with the use made of the property and the protection the property requires.

Land possesses characteristics distinguishing it from other forms of wealth and property. These are sufficiently basic to justify a different tax treatment of land than other kinds of physical possessions.

Land belongs to those groups of goods and services necessary for man's

<sup>16</sup> Nicholas Kaldor, *An Expenditure Tax* (London: Unwin University Books, 1955), p. 53. Incidence and tax burden analyses continue to be very unsatisfactory. For example, state and local property taxes are assumed to rest 50 per cent on consumption and 50 per cent on housing expenditures ("Tax Burdens and Benefits of Government Expenditures by Income Class, 1961 and 1965," New York: Tax Foundation, Inc., 1967, p. 44).

development and used by all men, but which are not produced day-by-day by man. Other examples of this type of goods are water, air space, sunshine, rainfall, and fish of the ocean. These goods with the exception of land and water have little economic value because they are not generally susceptible to exclusive use and control.<sup>17</sup>

Land, on the other hand, can be set aside for exclusive use. The one controlling land can benefit not only from the mineral and fertility qualities of the soil but also through use of earth space from enjoyment of air, sunshine, and rainfall, none of which have a cost of production to the owner. The quantity of land available is limited in the sense that the size of the earth is a finite quantity.

The limitation is much sharper with respect to particular uses of land. The limitation of quantity causes the price for control to be bid up. The increased value is created by the expansion of land uses. This expansion arises from the needs of the people which become effective demand through the increase of per capita and aggregate incomes.

In addition to its location value, land has a productive value. Minerals are extracted from the land. The basic quality of the soil plus man-produced fertilizers, pesticides, seeds, and to some extent water, combine with the climate to produce foods and fibers. These products from the soil give value to land as well as provide payments for capital, management, and labor. The control of the land is the basis for the development of a capital value. This capital value consists basically of the capitalization of the income represented by the difference in the average cost per unit of output of the land controlled and that of the land just able to produce with total costs of fertilizer and the like covered by selling price. The latter land is Ricardian no-rent land, which means it is also free land.

The levy of a tax on land does not in any important sense decrease quantitatively the amount of land. Taxation can only change the use made of land and therefore the quantity of land allocated for various purposes. The closer the tax comes to collecting the full surplus arising from the best economic use of land the closer the tax forces the highest use of the land. To reach the goal of various amounts of tax depending on the surplus productivity of a piece of land over free land it is not necessary to set a variety of tax rates each applicable to different parcels of land. All that is required is that a uniform tax rate be applied to the market value of land as determined by a combination of recent sale prices and the

<sup>17</sup> Henry George, *Progress and Poverty* (New York: The Vanguard Press, 1929), p. 132; Vernon T. Clover, *Property Tax on Houses and Concept of Justice*, (Lubbock, Texas: Texas Technological College, 1966), pp. 31-37

application of competent valuation procedures to develop what is called constructive market value.

Under the current system of property taxation and expenditure in effect in the U. S. the formation of property taxation districts including only a small number of persons, or only people during the day, or people requiring a relatively inexpensive package of services, can sharply reduce the portion of economic rent arising from the land that is collected as property taxes. The U. S. has hundreds of tax districts existing largely for the purpose of removing property including land from the tax base of populous school districts and residential areas nearby.

This establishment of a separate tax district to avoid assessment of property taxes on expensive structures and equipment may be desirable, for it could stimulate capital investment for an expansion of the productivity of workers and the general economic growth of a region or the nation. Low taxes on land value cannot find this justification because the cost of land is not made up by adding the various costs required for its production, except in a relatively minor sense or under unusual circumstances, such as where usable land is created by filling a swamp or cutting off a hill. Therefore, the quantity of land in aggregate is not determined by the uses to which it can be put that will be sufficiently productive to cover necessary costs, of which property taxes is one. This is true of structures and equipment, but not of land.

The *ad valorem* property tax assessed on land values acts to reduce the income the land provides to those controlling it. The reduction of income would take place in all instances except where for one reason or another the full economic price had been avoided until the tax based on land value was increased.

## VIII

### The State as the Property Tax Administrative Unit

THE STATE COVERS a very wide area of land. It is a differentiated political and administrative unit. On these accounts the levy of a uniform state tax based on the value of land would largely eliminate economic rent as private income arising because some land sites or tracts avoided their appropriate contribution to the costs of the society that created the income. A land value taxing district smaller than a state, for example a county, say Cook County of Illinois, would be a very substantial improvement over the smaller districts which now prevail. It would, however, be only a halfway measure, for education needs may lie almost entirely in one county while land values may be high in another county because of mineral resources or transportation.

It is true that different state policies regarding the use of land value as a tax base will create interstate border area difficulties and some uneconomic practices due to tax differences. These possibilities at this stage of the nation's development are unavoidable. However, because high land value taxes place pressures on land prices and because the raising of more funds in this manner is likely to mean lower property taxes on structures and personal property and also lower sales and income taxes, a land value tax competition might develop between states on the up side rather than the low side.

## IX

### The State as a Formulator of Education Policy

THE STATE DEPARTMENTS OF EDUCATION throughout the nation have become the developers of an educational policy stressing decentralization.<sup>18</sup> Local communities have lagged in taking responsibility. Modern transportation and communication plus the growth of the role of the state universities in teacher education make the situation an appropriate one for a state takeover. On the other hand local financing of education hinders implementation of sound educational policy. A major portion of the support for local financing arises directly from the widely-held concept of the property tax. Therefore the property tax as a financer of education can become consistent with the current base of education policy development only if that portion of this tax used to meet the costs of education becomes a state tax.

## X

### Uniformity of Education Needs

THE STUDENT whether he lives in a poor or rich area of the nation attends school to assist him to meet the requirements of modern living. This means that he must acquire a certain competence in reading, mathematics and the use of English. The desirability of meeting these basic goals efficiently does not vary from community to community. It does not even vary significantly from nation to nation.<sup>19</sup>

In addition, the student attends school to learn of the history and culture of his own community, state and nation and of the world. Again the appropriate variation between geographical areas is minimal. Certainly

<sup>18</sup> Martin Essex, "Urgent New Dimensions for American Education," *North Central Association Quarterly*, Vol. 42, (Spring, 1968), pp. 294-300.

<sup>19</sup> Reese, E. Dukes, "Cultural Lag in Education," *Peabody Journal of Education*, Vol. 45, (September 1967), pp. 32-4.

the area of a state is small enough to make uniformity of approach appropriate under nearly all circumstances.<sup>20</sup>

The cost of quality instruction and school administration varies very little from area to area. Where living costs are low so are the amenities. The result is great uniformity in personnel costs. Materials, of course, also vary little from one area to another.

## XI

### Local Government Reaction to State Use of Land Value Taxation

THE USE OF A UNIFORM land value tax by the state would provide it with additional funds and would, of course, reduce the value base available for the application of local property taxes. Although these shifts are not directly within the scope of this analysis, they cannot be completely avoided. Following this line of reasoning, quite practical general approaches to the adjustment are outlined in the next several paragraphs.

The local governments could continue to levy land value taxes which would be in addition to those levied by the state. Local governments could readily do this because the state in the administration of its property tax would have necessarily established a value for land separate from structures on the land. The local governments could continue to tax structures and personal property as before. Or they could move toward the "contract city" and collect amounts calculated on the basis of cost of services required and enjoyed. The latter approach to the own-source-financing portion of nearly all local government expenditures other than education is more feasible than local government officials have generally believed.<sup>21</sup>

The revenues collected by the state government from land value taxation would be used as considered appropriate. At the start, at least, one would expect the state to use the revenues to supplement other income now being spent to support local education activities. If the distribution is made on the basis of the number of students using public education of various types—hopefully on a relatively simple formula—progress could be made toward a more equal level of education opportunity and a more

<sup>20</sup> Warren C. Davis, "Education for Service and Product Diversification," *School and Society*, Vol. 96, (Jan. 20, 1968), pp. 42-3.

<sup>21</sup> J. A. Stockfish, "Fees and Service Charges as a Source of City Revenues: A Case Study of Los Angeles," *National Tax Journal*, Vol. 13, No. 2 (June, 1960), pp. 97-121; and William W. Vickrey, "General and Specific Financing of Urban Services," in *Public Expenditure Decisions in the Urban Community*, ed. Howard G. Schaller (Baltimore, Md.: The Johns Hopkins Press, 1963), pp. 62-90. Milton Z. Kafoglis, *Welfare Economics and Subsidy Programs* (Gainesville: University of Florida Press, 1962).

equal distribution of education costs.<sup>22</sup> Each dollar of land value throughout the state would bear the same state tax burden for the support of local education opportunities. But the amount spent in a particular school district may be more or less than the amount collected from the state tax on the value of land located within the geographical area covered by the district.

The local school district with a relatively high aggregate land value in relation to number of students, would most likely find the state return of property taxes to be less than the previous collection had been. Under these circumstances an additional local tax on land values would be one way for the district to continue to enjoy a more expensive per student public education experience than the rest of the state.

Calculations based on the relationship of land values to total real estate values in California show that the rate on land values would have to be 2.2 per cent to raise an amount equal to "the entire yield of the existing property tax." Since local education expenditures are currently absorbing about 50 per cent of total property tax collections, a property tax rate of 1.1 per cent on land values alone would meet local education needs.<sup>23</sup>

## XII

### Economic and Administrative Rationale of State Property Tax

GRADUALLY THROUGH THE YEARS, as was shown above, the value of property acquired an entirely local situs. The historical development of this idea permitted property located in one place, and particularly land values, to bear a much different tax burden than property located in another, only a short distance away. The situation is an historical accident and does not possess either an economic or a political reality.

Land values develop through the cooperative effort of many. This is perhaps even more true in the case of land values than of aggregate sales or personal income. The value of land is not created by the people who happen to live in the immediate area. The state as a major political division has a clear claim to the economic rent enjoyed by the owners of land, for the state represents a sufficiently large aggregate of people to be justified in claiming that its members should share in incomes giving land value. Taxes levied on land values are surpluses created by a large community, and the benefits of expenditures are rightfully distributed if shared by many. The Suggested Property Tax Legislation prepared by the Advisory Commission on Inter-Governmental Relations has moved a long

<sup>22</sup> Roger A. Freeman, *Taxes for the Schools* (Washington, D.C.: The Institute for Social Science Research, 1960), pp. 73-80.

<sup>23</sup> Netzer, *op. cit.*, p. 211.

way toward greater state control of property tax administration. However, the next step after state control, a uniform state property tax levy, is not taken. It would appear this shortfall is politically dictated and does not rest squarely on the direction of the Commission's analyses of state and local government expenditure and revenues.<sup>24</sup>

The Advisory Commission points out in developing the case for a state general property tax that:

A main defect of the separation of sources policy that assigns the general property tax to be levied by local governments for their basic support is the failure of the distribution of taxable property in a state to coordinate with the cost of local government.<sup>25</sup>

The report goes on to point out all the problems that separation of tax sources has developed. For example, metropolitan planning has been seriously hindered and inefficient subdivision of local government has been encouraged.

The idea of developing what has come to be called "economic balance" in an area as small as a school district or township is sheer nonsense. It is quite impossible to develop property values in all areas sufficient to meet average local government-owned source revenue needs. The realization of this impossibility is the source of the original popularity of establishing the foundation programs in the area of general local education programs. The fact that property of equal value bears unequal tax payments in support of public education vitiates the program. Yet this is the case "when wealthy school districts can meet the foundation by levying less than the mandated rate or are guaranteed specified amounts of state aid regardless of their high fiscal ability."<sup>26</sup>

### XIII

#### Conclusion

THE APPLICATION to property taxes of the concept of the separation of the sources of tax revenue used by local governments from that used by state governments no longer works to increase the efficiency with which the property tax is administered. The economic and political truth still existing in the separation of services concept applicable to this situation is found in the local urban area levying on structures and personal property fees and taxes closely related to benefits received and costs incurred—the

<sup>24</sup> Excerpts from 1965 State Legislative Program of Advisory Commission on Intergovernmental Relations (Washington, D. C., September, 1964), pp. 14-18.

<sup>25</sup> "The Role of the States in Strengthening the Property Tax," Vol. I, (Washington, D.C.: Advisory Commission on Intergovernmental Relations, 1963), p. 73.

<sup>26</sup> *Ibid.*, p. 75, and Jesse Burkhead, *State and Local Taxes for Public Education* (Syracuse, N. Y.: Syracuse Univ. Press, 1963), p. 43.

"Contract City." Its appropriateness based on having the revenues raised by those who make the policy no longer exists in education.

The benefit property owners subject to the property tax enjoy from education expenditures is not unique and therefore does not justify the *ad valorem* property tax being collected on a basis other than ability-to-pay or share of produce of society enjoyed. However, land as a portion of real estate is unique and this uniqueness justifies society sharing more completely in values arising from land ownership than values (income) arising from personal effort. Society's wish to use its share to support public education is appropriate. However, the division of the income source area into little districts makes for inefficiency and the waste of portions of this resource that could be available to society to support its education expenditures.

The change recommended is for the state to levy a uniform property tax on land value only, the rate to be high enough to replace local support of primary and secondary education. The collections from the state land value tax distributed to support education would be about 50 per cent of total current property tax collections. This would work toward equalization and improvement of public education and would improve the property tax as an economic and political institution.

State and local taxation must be studied constantly to make them better fit the conditions of today.<sup>27</sup> The current situation of primary and secondary education policy development and the political and economic requirements for effective use of the property tax point to a trend along the lines outlined above.

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<sup>27</sup> L. L. Ecker-Raez, "State Taxes for the 1970s," *State Government*, Vol. 39, (Winter, 1966), pp. 14-19.

*International Development and Peace*

NEVER BEFORE IN HISTORY has the disparity between the rich and the poor, the comfortable and the starving, been so extreme; never before have mass communications so vividly informed the sufferers of the extent of their misery; never before have the privileged societies possessed weapons so powerful that their employment in the defence of privilege would destroy the haves and the have-nots indiscriminately. We are faced with an overwhelming challenge. In meeting it, the world must be our constituency.

I can find no better words to express this view than those employed in General Principle Four of the Final Act of the 1964 United Nations Conference on Trade and Development:

Economic development and social progress should be the common concern of the whole international community and should, by increasing economic prosperity and well-being, help strengthen peaceful relations and cooperation among nations.

These interests and these benefits submit to no national boundaries. The social, economic, and political betterment of any man anywhere is ultimately reflected in this country. If, at the same time, our consciences—our humanitarian instincts—are served, as they are and as they should be, then so much the better. Unquestionably, the conception of international assistance is appealing because it is one of the most uplifting endeavours in which man has ever engaged. But we must never forget that in this process Canadians are beneficiaries as well as benefactors.

The long-range benefits cannot be over-emphasized. As Canadians, we must realize that international cooperation, particularly in the field of economic assistance, in order to remain effective must take on a new form. From the present pattern of commodity and food assistance, of gifts of manufactured goods and loans of money, we must, in response to the economic needs of the developing countries, turn more and more to preferential trade arrangements. The two United Nations Conferences on Trade and Development have made it clear that economic aid, in order to be effective, must increasingly take the form of trade. [From an address.]

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# New York City's Fiscal Situation\*

By FRANCIS X. SMITH

## I

### Federal Revenue Sharing

DURING THE TEN-YEAR PERIOD from 1956 to 1965-66, the scale of city government finances virtually doubled throughout the country. Total revenue of city governments rose 100 per cent, total expenditures increased 99 per cent, and total indebtedness was up 92 per cent.

These are significant increases, of course, but they seem minor when compared to the situation in New York City. In the last ten years the city's budget has increased from \$1.9 billion to over \$6.6 billion, an increase of over 300 per cent.

New York in 1967 had an expense budget of \$5.24 billion, of which \$1.6 billion came from property taxes. Chicago, on the other hand, had an expenditure level of only \$423 million. It took in a general revenue of \$407 million of which \$210 million came from property taxes.

Los Angeles had an even lower expenditure and revenue level. Its general expenditure and revenue was \$384 million, \$79 million of which came from property taxes.

Thus, New York was operating at an expense level almost twelve times as high as that of Chicago and almost fourteen times as high as that of Los Angeles, although in population New York is only twice as large as Chicago and three times as large as Los Angeles.

The long-term debt situation is similar. New York by 1965-66 had a long-term debt of over \$7 billion, compared to \$810 million for Chicago and \$892 million for Los Angeles.

Since World War II the level of demands placed upon New York City has increased to the point where it now simply does not have the resources with which to pay for the services New Yorkers desperately need. This relatively new situation is caused by what might be called "the total mobility of the poor." Since World War II many factors have combined to cause a great migration of people from conditions of poverty in the South, Puerto Rico, and other parts of the country to New York City.

When the poor were dispersed in little villages throughout the South, few people knew or cared about them. But when they became concentrated in New York they became extremely "visible." The obviously

\* A report to the public issued June 15, 1969 by the President of the City Council of the City of New York.

great social problems that both they and the city now face lie so heavily on the collective conscience of our society that immediate measures are taken to ameliorate them. The costs incidental to concentrated poverty are the cause of the fiscal crisis New York, like the rest of our cities, now faces.

The poverty problem in New York is not the "fault" of New York. Most of the people needing welfare assistance came to New York because conditions are better in New York than they were in the places from which they came. They did precisely what we of the earlier immigrations did in the same circumstances. As long as the problems of poverty are neglected in the communities from which the poor now emigrate, this mass migration will continue and the almost impossible financial burdens on our city will increase.

There is only one way out, and this solution has been recognized by the majority of people vitally concerned with the future of our cities. The present situation demands a national program, as the problem itself is national and totally incapable of local solution. The federal government must bear the local costs of the national problem—including welfare, health services and local education necessary to approach a solution to the poverty problem.

The Federal Government must support the poverty-linked services of our cities. Alone the cities surely cannot provide minimally adequate levels for these vital services. According to the Regional Plan Association's report on *Public Services in Older Cities*, New York City needs another \$1.5 billion now to provide minimally adequate levels for poverty-linked services (besides the total of over \$2 billion New York City presently spends every year). But it certainly does not have the taxable capacity to finance what is really needed.

Certainly the City of New York can keep raising taxes, as is the present policy. But it does this at an extremely great risk—the risk of inducing taxpaying residents and business firms to move elsewhere. Such a policy, of course, increases our problems instead of solving them, and the evidence is that this is precisely what has been happening in New York City. Besides, most types of local taxes fall most heavily on the poor, the result being that we tax the poor to assist the poor, which is surely an absurd policy.

Thus some form of federal revenue-sharing is a vital necessity if we are to do what we know must be done!

## II

## The Real Estate Tax

AS LONG AS OUR CITIES do not get the federal aid they so greatly need, they will have to rely on the present tax structure, which is based primarily on the real estate tax.

New Yorkers in recent years have been faced with a yearly increase in the real estate tax since Mayor John V. Lindsay took office. In 1956 the rate was only \$4.56 per \$100. Today it is \$5.218 per \$100, the highest rate in the history of the city. The tax is designed to provide for the increasing rate of services that it now provides. Each year, as the urban crisis grows more serious, the budget goes up and so does the real estate tax. Yet the city leaders have not considered the great impact that real estate taxes have on the entire urban situation.

Much of the present supply of housing in New York City is of poor quality, not only because it was inferior when originally built but also because it has been allowed to deteriorate.

The maintenance on even a small portion of the properties in a neighborhood can materially affect the entire community. Over time, the owners and tenants of older housing may do more than preserve the quality of their own housing. By striving to maintain and improve their houses, they can set a pattern to be followed by others. Adequate maintenance of the existing stock of housing is vitally important in combating today's housing crisis.

Yet property taxes as they are presently set up work against maintenance and improvements of existing housing. They influence maintenance in several ways:

First, they reduce the net return from property and thus its attractiveness as an investment. In marginal cases, therefore, where the return is very low and the taxes are high, abandonment of housing often results. By June, 1968, owners in New York City abandoned about 12,000 buildings with between 125,000 and 150,000 units.

Second, maintenance expenditures may lead to higher assessments. The higher the tax rate the greater will be the owner's incentive to avoid improvements which may raise his assessment. With or without good reason, the owner may fear that a repair or maintenance job having visible results will result in an appreciable assessment increase.

This is far from being a merely theoretical problem. When a recent survey asked tenement landlords about the factors which determined their outlays for maintenance and improvements, the replies clearly indi-

cated that rising tax rates had hindered maintenance not only by reducing the income from investments but also by adding to the fear of upward reassessment if "visible" repairs were undertaken.<sup>1</sup>

The present property tax structure is a distortion of common sense when it applies to older property, especially in urban areas. New, well-constructed, well-maintained buildings are taxed far more heavily than a slum dwelling of the same size, on the same property. Can justification for such discrimination be found in the cost differences which the two types of property and their occupancy impose on local government? Certainly not, for the badly run-down building creates greater costs for the city, if only for fire and police protection. The user's payment for the services of local government goes down, relatively, as the building deteriorates, even though public expenses attributable to the property may indeed increase. In other words, owners of such run-down buildings who put the community to relatively heavy expense pay less in taxes than the owners of higher quality buildings.

The property tax thus creates an incentive against upgrading of quality in just those parts of older cities where the need is greatest. Heavy taxation of new or old well-maintained buildings is a prime example of our placing needless obstacles in front of ourselves. Cities that urgently need to replace obsolete, decayed, degrading buildings—not to speak of already abandoned ones—nevertheless put powerful tax impediments in the way of progress. Thus the tax as it works out in practice actually favors those who hold on to the decrepit structures, many of which spread an evil influence through a larger area, while penalizing those who keep well-maintained buildings that are a source of benefit to the whole neighborhood.

Good urban management would use price differentials of various kinds to reward behavior which has a favorable impact on our housing supply. A dangerous firetrap should pay more, not less, in benefit-type taxes than a modern, fireproof building of higher value. When an owner puts in a new garbage-disposal unit or paints the outside of his building or installs a safer furnace, he often faces an assessment increase. He is causing the city less real cost and at the same time he is creating social benefits—yet in return we perversely increase his tax liability.

### III

#### Proposal for Restructuring the Real Estate Tax

WHAT CAN WE DO to reverse the inequities in the present real estate tax

<sup>1</sup> See George Sternlieb, *The Tenement Landlord* (New Brunswick, 1966).

system? The basic problem is the fact that the real estate tax at present is not designed to effect the most efficient possible use of the land. In reality, the property tax can be thought of as a composite of two tax levies, one on land and one on improvements. A high rate on the land will put pressure on the owner to utilize the land in the best, most efficient manner possible.

C. Lowell Harris, professor of economics at Columbia University and vice president of the Tax Institute of America, has proposed that the real estate tax be broken up into two separate levies—one on land and the other on improvements. The rate on land values, he suggests, should be substantially higher than the rate on improvements. High rates on scarce urban land would induce owners of low-use land to convert to higher value use. Meanwhile, the lower tax rates on buildings would encourage replacement of old structures by new ones, as well as encouraging improvements on existing structures.

This is no radically new proposal. A long trend of thought beginning with Henry George's *Progress and Poverty* has strongly advocated taxing land values heavily because "land is a gift of nature and yields its owners an unearned income." Moreover, these economists argue, since the supply of land is fixed, "no level of taxation up to its full earnings would reduce the supply of land available to society."<sup>2</sup>

On the other hand, this school of economists argues that taxes on improvements should be slashed (and, as the more radical ones argue, even eliminated). In practice, they argue this would result in an equitable tax rate for conscientious and socially responsible landlords as well as for slumlords.

In practice, exclusive or differentially heavy taxation of land values today exists in parts of Canada, Australia, New Zealand, South Africa, and Denmark, and in Hawaii and Pennsylvania (notably in Pittsburgh).

*The Final Research Report to the Temporary Commission on City Finances* recommended that the New York City Administration seriously study the feasibility of instituting such a system. "Land value taxation," it noted, "has enough merit on its face to warrant a detailed examination."<sup>3</sup> Considering the great benefits such a plan may have it is difficult to understand why even this has not been done.

<sup>2</sup> Wilbur Thompson, *A Preface to Urban Economics* (Baltimore: Johns Hopkins Press, 1965).

<sup>3</sup> *Financing Government in New York City* (New York: New York University Graduate School of Public Administration, 1966), p. 73.

## IV

## Summary

THIS PAPER CALLS FOR federal revenue-sharing as the only long-range solution to the unique poverty-related financial problems facing our cities. We have no illusions regarding the problems involved. Yet we are closer to this solution than ever before. In recent years there has been a proliferation of federal programs designed to help the city meet its needs—antipoverty programs, housing programs, model city programs, health programs, etc. Indeed, almost every department and agency has some programs on these lines and large catalogs are needed just to list these programs. So the beginning of awareness of our great needs already exists.

Transferring full financial responsibility for poverty-related public services to the federal government—with the doubling of services that the Regional Plan Association calls “minimally necessary”—would mean a rise in the federal budget of about \$20 billion a year. Federal revenues, the Regional Plan Association estimates, will increase by \$20 billion in just over two years without any change in tax rates.<sup>4</sup> This will be the result of the increase in the gross national product and indicates the fiscal feasibility of these proposals.

The poverty burdens must be transferred completely to the federal government and uniform standards should be set up throughout the country so that no artificial pressures are again put on any local areas (such as mass migration from one area to another). The pitifully inadequate piece-meal handout policy that now exists must be totally replaced.

The city should immediately undertake a study of the effects of the real estate tax to see whether the structure of the tax should be changed as outlined above so that no longer will it create incentives against upgrading of quality in just those areas of the city where the need is greatest. The tax must no longer favor those who hold on to their decrepit structures while penalizing those who invest money to build up their properties and maintain their buildings in the best possible condition.

The tax structure must be thought of not only as a needed device for raising revenues but also as an instrument for change. If it is used wisely it can be a strong influence for change in the needed direction.

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<sup>4</sup> *Public Services in Older Cities*, (New York: Regional Plan Association, 1968), p. 8.

# On Affluence and Economic Conflict

By DAVID KLINGAMAN

## I

EXCHANGE IS A PECULIAR FORM of agreement in that the interests of the parties involved are partly in conflict.<sup>1</sup> Since ours is an exchange economy, the subject arises as to whether the scale of economic conflict should theoretically become less intense as the supply of goods produced by the economy's resources increases. The question considered here is whether high and growing per capita consumption would tend to lessen economic conflict among people for the economy's output of goods and services.

In theory at least, conflict can be measured by the intensity with which the individual applies himself to the bargaining aspect of the exchange agreement and by the time input involved in bargaining. Exchange agreements may be defined as contracts negotiated in order to exchange labor services, non-monetary assets, or monetary assets among persons. It is the existence of mutual gains from trade which induces individuals to make contracts with one another, and each individual endeavors to drive a shrewd bargain in order that he may increase his total utility both absolutely and relatively to that of his fellows. Thus aggregate economic conflict among persons in society would seem to be a function of the number of agreements struck and the amount of bargaining which entered each of those agreements. In order to consider whether growing per capita consumption tends to reduce conflict, it is necessary to analyze the effect of affluence on each of these indicators of conflict.

As a society becomes more affluent, each individual's consumption of goods rises and his portfolio of assets increases. Does this process of rising consumption and accumulation tend to reduce economic conflict among persons? In order to answer this question, it may be useful to reason backwards. One can theoretically conceive of a situation in which a given set of owned goods is so abundant that no individual desires more of any good; the marginal utility of each good is zero or less. In such a state of bliss the number of exchange agreements would be zero, and there would be no economic conflict.

Now suppose that each individual's portfolio of assets is gradually and equiproportionately reduced. At some point in this decumulation process,

<sup>1</sup> The theory of private goods exchange is rigorously developed in Peter Newman, *The Theory of Exchange* (Englewood Cliffs, N. J.: Prentice-Hall, 1965).

each individual will incur a utility loss as one more unit of a good is deducted from his portfolio. The precise point where this occurs will vary over goods for each person and over persons for each good. As the decumulation process begins to subtract units which have a positive marginal utility, the owner will be motivated to replace that good by engaging in trade. Eventually some point is reached where each individual wants more of each good in his portfolio. At this point the number of exchanges should cease increasing since now all individuals are motivated to trade for all goods in their portfolio. The permutation of exchange agreements is potentially maximized when each individual is motivated to trade for each good. The number of exchange agreements is not reduced as affluence proceeds so long as each individual wants more of each good. But should affluence proceed to the point where some goods are possessed to satiety, the number of exchange agreements should decline and economic conflict should diminish.

## II

THE AFFLUENT SOCIETY, however, is not one of an unchanging set of goods. Once one drops the assumption of a given set of goods in order to allow for the introduction of new goods, the number of exchange agreements is positively affected. When one good is dropped from the trading permutation due to general satiety, a new good may take its place. Thus if economic conflict is a partial function of the number of exchange contracts, the scale of economic conflict is not extenuated by the introduction of new goods—quite the contrary.

Long before the supply of goods increases to the point where the number of exchange agreements begins to decline, growing affluence may affect economic conflict through its impact on bargaining intensity or bargaining time. It seems reasonable that the amount of time which an individual is willing to invest in bargaining on a specific contract is a function of the expected utility to him in arriving at such a contract. If the marginal utility of an individual's portfolio of assets diminishes, growing affluence may weaken the motivation of individuals to acquire assets and increase consumption. Since time is one of the objective costs involved in arriving at an exchange contract, a richer society may prefer to allocate less time to establishing relatively more advantageous exchanges.

Thus if economic conflict is a partial function of bargaining intensity or of the time spent in bargaining, it may be lessened by greater affluence. The emergence of new goods in the economy may tend to offset this factor

however. New goods will not only theoretically increase the exchange permutation but may also induce individuals to expend more bargaining time and effort in obtaining them. This would be true if the acquisition of a unit of a new good involves more utility than an additional unit of an old good. The propensity of individuals to bargain would presumably be enhanced by the availability of new goods.

Changes in taste may also affect the propensity to bargain for some goods although probably not for the whole set of given goods. The change in tastes is a factor making for greater economic conflict primarily with respect to the introduction of new goods, including in this last category qualitative improvements in old goods. The propensity to bargain in the economy is also affected by external shifts in the probability of individuals or groups in society of achieving more advantageous exchange contracts. The increased willingness of the Black Community, for example, to devote more time and energy to negotiating relatively more favorable exchange contracts (public as well as private) may be interpreted as an increase in the probability of their achieving such relatively more favorable exchange agreements.

The concept suggested here appears to derive some empirical support from the process of expansion in the public goods sector. The extension of public goods into new areas of provision seems to be accompanied by an increased willingness to invest time in bargaining.<sup>2</sup> Relatively less bargaining appears to be involved in an equivalent expansion of old public goods programs. There may, of course, be other explanations for this apparent phenomenon. From the individual-voter-taxpayer's view, however, the introduction of a new public good may be worth investing relatively more time in bargaining because he expects that the utility which he will receive from it will exceed that which he would obtain from an equivalent (monetary) extension of an old public good program.

In other words, the marginal utility of the new public good is relatively higher so that the individual is willing to invest more time in contracting to acquire it. If this is true, the extension of the public good sector into new fields will be accompanied by increased economic conflict. On the other hand, and analogously to the private goods sector sans new goods, the gradual extension of old programs should be attended by diminished conflict.

<sup>2</sup> In this case the "political exchange" emerges from the political decision structure. Cf. James M. Buchanan and Gordon Tullock, *The Calculus of Consent* (Ann Arbor: Univ. of Michigan Press, 1962); James M. Buchanan, *Public Finance in Democratic Process* (Chapel Hill: The Univ. of North Carolina Press, 1967); James M. Buchanan, *The Demand and Supply of Public Goods* (Chicago: Rand McNally & Co., 1968).

## III

IN CONCLUSION, this note has suggested a theoretical framework for thinking about the aspect of economic conflict in society. It was mentioned that there may be a negative correlation between the quantity of goods which people own and the time and effort which they are willing to expend in making contracts for more of those goods. If so, the consequent reduction in bargaining intensity and bargaining time may, as affluence advances, lead to less economic conflict in the economy. The introduction of new products and shifts in consumer tastes and expectations may be factors making for constant and even greater economic conflict. The other factor producing economic conflict—the number of exchange contracts—is unlikely to diminish as affluence proceeds, at least until same goods are held to satiety.

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*Dissent in a Free Society*

OUR SYSTEM MUST—and it does provide for dissent and opposition, but we should begin with the premise that a solution must remain within our basic structure of constitutional, free government.

For dissent to be responsible, it must also be *relative*; that is, it should be kept in perspective, particularly its method of demonstration. I am sure we would all agree that self-immolation is a rather excessive protest against a neighborhood zoning change. At the other extreme, however, is the *shallowness* of protest in the muttered "it's terrible" when people are murdered in an effort to exercise their constitutional rights at the ballot box or upon the public highways. Both the extent and form of the protest must be related to the *target* of the protest. [From an address.]

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*New Journal in Economics*

A NEW JOURNAL has been established for economists. Called the *Journal of Economic Theory*, it is specializing in original articles in economic theory and related mathematical technics. A quarterly, the journal is edited by Professor Karl Shell, Department of Economics, University of Pennsylvania, Philadelphia, Pa., 19104, to whom manuscripts may be addressed. The journal is published by Academic Press, Inc., 111 Fifth Avenue, New York, N.Y. 10003.

# Economic Self-Interest and Social Progress in Talmudic Literature:

## *A Further Study of Ancient Economic Thought and Its Modern Significance*

By ROMAN A. OHRENSTEIN

### I

#### Introduction

IN A PREVIOUS STUDY I attempted to analyze some of the economic concepts in *Talmudic* sources.<sup>1</sup> I endeavored to demonstrate examples of penetrating economic analysis as they were deduced by the *Talmudic* writers and to show the relevance of those doctrines to modern economic thought.

The "*Talmudic* sea" (so described for its scholastic breadth and intellectual depth) is partly *Halakha* (legalistic) and partly *Haggadah* (homiletical). The purpose of this essay is to investigate some of the *Haggadic* insights into human nature and their relationship to the socioeconomic philosophy of the modern age. But I should first like to say something about the character and methodology of *Haggadah*.

*Haggadah* (or *Aggadab*) comprises the non-legal contents of the *Talmud* and *Midrash*. It includes, among other things, moral and ethical teaching, theological speculation, philosophy, legend, folklore, historical and economic information, etc. About one third of the *Palestinian Talmud* and approximately a fourth of the *Babylonian Talmud* consist of *Haggadah*. Sometimes *Halakha* and *Haggadah* are mixed together so that the latter interprets the former. *Haggadah*, like *Halakha*, is coordinated by a complex system of "value-concepts" that find their concrete expression in human experience.

Although *Haggadah* has no systematic philosophy, it deals in its own way with basic theological and moral problems. It is noteworthy that many non-Jewish concepts found their way into *Haggadah* and much Greek thought left its trace there.<sup>2</sup> The extent of such influence may be seen

<sup>1</sup> See R. A. Ohrenstein, "Economic Thought in Talmudic Literature," *Am. J. Econ. Sociol.*, Vol. 27 (April, 1968).

<sup>2</sup> *Encyclopedia of the Jewish Religion*, R. J. Zwi Werblowski and G. Wigoder, eds. (New York: Holt, Rinehart & Winston, Inc., 1965), pp. 15-16.

from a theological controversy recorded in *Talmudic* literature<sup>3</sup> which took place during the 2nd century B.C.E. As we shall see, the nature of this dispute has special bearing upon the subject to be analyzed because of its socioeconomic background.

The conflict originated within the *Sanhedrin*<sup>4</sup> as a result of a clash of ideas between Hellenism and Judaism.<sup>5</sup> As the Hellenistic notions gained momentum, Antigonus, (2nd century B.C.E.) then a prominent member of the "Chamber of Hewn Stones," resigned his lucrative post presumably in protest against the prevailing atmosphere of Hedonism. Upon leaving he challenged his contemporaries with the following exhortation: "Be not like servants who serve their master in order to receive wages. Be rather like servants who serve their master without expectation of wages."<sup>6</sup> Thus, the true reward, according to Antigonus, comes from rendering services out of pure and unselfish motives. Those who remained in the "chamber" objected vigorously to Antigonus's ascetic dictum. Inasmuch as the piety of the priestly aristocracy was prudential, like their ethic, they saw no contradiction between moral virtue and material benefit.

As we see, there were two schools of thought. One, that of Antigonus, put faith in the natural goodness of man and advanced the idea that true virtue must be selfless. The other emphasized a sort of rational self-interest, inevitable and not deplorable at all. The latter was, to use a Schumpeterian expression, "a highly sublimated egocentric hedonism."<sup>7</sup> Interestingly, this *Talmudic* controversy has its counterpart in the various views of the 18th century philosophers. As is well known to students of economic thought, these discussions pertaining to moral sentiments ushered in the spirit of *laissez-faire*, a concept which served as a philosophical prelude to the economic liberalism of Adam Smith.

At this point it is important to note that the views of Adam Smith, the economist, were greatly influenced by the writings of Bernard de Mandeville (1670-1733), the moral philosopher. However, the views that are

<sup>3</sup> See *Abot of R. Nathan*, Vol. I, ch. 5, 13b.

<sup>4</sup> The term *sanhedrin*, derived from the Greek, means council court. The *Sanhedrin* flourished during the latter part of the Second Temple period.

<sup>5</sup> See in particular Mayer Mizlish, *Otzar Khakhamay Hatalmud*, B'nai Brak, Friedman, eds., Tel Aviv, 1966, p. 145. In this investigation I am concerned primarily with the socio-economic aspect of the controversy. For a penetrating analysis of the theological side of the dispute, see Louis Finkelstein, *The Pharisees* (Philadelphia: Jewish Publication Society of America, 1962), Vol. II, pp. 762-79.

<sup>6</sup> *Abot*, *op. cit.*, Vol. 1, ch. 3.

<sup>7</sup> Joseph Schumpeter, *History of Economic Analysis* (New York: Oxford University Press, 1962), p. 66.

said to have had such an impact on Adam Smith's thinking were expressed by Mandeville not in prose but in a doggeral poem, "The Grumbling Hive" (1705), subsequently renamed "The Fable of the Bees." In describing allegorically the dishonesty and selfishness of the "beehive," he shocked many of his contemporaries with his unconventional assertion that in the world in which we live—*good is based on evil*.

In his fable Mandeville probes the deepest recesses of human consciousness—man's nature, motivation and experiences. Accordingly, vice and virtue, though two opposite phenomena, not only interact, but actually benefit from one another.<sup>8</sup> Strangely, however, the views expressed in Mandeville's fable early in the 18th century, seem to have been anticipated about 1500 years earlier by *Talmudic* scholars. They too sought to focus man's attention upon the extraordinary sociopsychological process, the "spiritus movens" of human existence which the *Talmudists* describe as the "evil impulse" that is instrumental in advancing civilization.

The *Talmudic* fable to be presented here integrates two seemingly unrelated ideas, the national and the universal. This is not surprising, since in the complex world of the *Talmud* the particular and the general, the logical and the theological, the national and the universal, like an oriental tapestry, are all intricately interwoven. Its *leitmatif*, therefore, is fluid—national in character, universal in scope.

The parable is filled with drama and suspense. The reader is transported back to a moving event that took place circa 450 B.C.E. In the background the *Talmudic* writers visualize how the returnees from Babylonian captivity mourn over their national disaster. But suddenly their somber mood is transformed into a drama of universal import.

In order to *accentuate* the similarity of the views reflected in both fables, we venture to phrase the *Talmudic* parable in the literary form employed by Mandeville.

<sup>8</sup> See Anthony, Earl of Shaftesbury, *Charismatics of Men, Manners, Opinions, Times*, 5th, ed., 3 vols. (Birmingham, England: John Baskerville, 1733); Bernard de Mandeville, *The Fable of the Bees, or Private Vices, Public Benefits*, with a commentary, critical, historical and explanatory by F. B. Kaye (Oxford, England: Clarendon Press, 1924), 2 vols.; Francis Hutcheson, *An Inquiry into the Original of Ideals of Beauty and Virtue* (2d ed., London, 1726); Adam Smith, *The Theory of Moral Sentiments* (8th ed., London and Edinburgh, 1797), 2 vols. To sum up their views on that question, Lord Shaftesbury's basic thesis was that man possesses altruistic and gregarious feelings. Hutcheson supported this viewpoint, holding that "love and benevolence, the very name excluded selfishness." Mandeville, like Hutcheson, admitted the reality of compassionate impulses but insisted on terming *all* natural emotions selfish, whereas Hutcheson defines *some* of them as altruistic. Adam Smith in his exposition of laissez-faire and its basis repudiated Hutcheson, to come close to Mandeville.

*The Fable of the "Evil Impulse"*<sup>9</sup>

Woe, woe, it is he! the idolatrous passion,<sup>10</sup>  
 Israel has been exiled, the sanctuary destroyed;  
 The righteous were slain, no compassion . . .  
 Yet still he is dancing amidst our void.  
 Hast Thou planted in us the impulse to kiss  
 That we may battle his tempting sword,  
 To receive thereafter Thine eternal bliss?<sup>11</sup>  
 Why, we want neither him nor his reward!  
 The Heavens approved—a tablet fell down,  
 "I agree"—it read—"you spoke the 'truth'."  
 A three-day fast they ordered on their own,  
 "Let's capture him and never let him loose."  
 Suddenly he came forth from the Holy of Holies,  
 A young lion aglow spitting with fire  
 They wrestled with him to subdue their follies,  
 He surrendered, roaring—"I lost a 'hair'"!<sup>12</sup>  
 Seeing that this is a time for heavenly Grace  
 They prayed for mercy to hand them "Yetzer," the Base.  
 As they triumphantly subdued the evil desire,  
 "Beware"!—the prophet thundered—  
 "If you kill him the world will expire!"  
 For three days the "Evil Yetzer" was imprisoned;  
 Temptations vanished, greed and pride ceased.  
 Hurrah! the battle over, the sex-impulse is won—  
 Alas . . . a fresh egg is needed, there is none.<sup>13</sup>  
 What shall we do?—they now intensely thought,  
 Shall we kill him? the world couldn't survive,  
 No one would build, nothing be sold or bought  
 Neither shall one marry, no children, no drive.<sup>14</sup>  
 At last it dawned—a truth profound

<sup>9</sup> Translated and paraphrased by the author from the original sources—based on a story told in the *Babylonian Talmud*, *Yoma*, 69-b, *Sanhedrin*, 64-a with minor elucidations from *Midrashic* sources. The rhyme here is incidental; no poetry is intended.

<sup>10</sup> The evil desire, temper of the idolatry, i.e., *Yetzer Ha-rah*. For the etymological derivation of "*Yetzer-Ha-rah*" or "evil impulse" and its various meanings, see George Foot Moore, *Judaism*, (Cambridge, Mass.: Harvard Univ. Press, 1950), Vol. 1, pp. 479-91. The impulse of idolatry and immorality are considered to be similar and reinforcing each other.

<sup>11</sup> For resisting the evil impulse Israel would be rewarded.

<sup>12</sup> See Samuel Edels (Maharsha), commentator *ad Talmud Yoma*, 696b. The "hair" is a metaphor for the biblical Easu, (who was all "hairy") and for his mentor-angel considered by the rabbis as the "temper of idolatry."

<sup>13</sup> See Rashi, *Sanhedrin*, 64-a. The normal temperature necessary for procreation was reduced considerably both in male and female so that even when the egg happened to ripen the chicken could not lay it.

<sup>14</sup> *Midrash Rabba* (Jerusalem: Wahrman Books, 1965), ch. 16. "Were it not for the evil impulse, no man would build, procreate, or engage in business enterprise." See also *Midrash Kohelet Rabba*, 4:4 and *Yalkut Shimoni*, Pardes ed. (1944), ch. 16:5, p. 9.

In scheme divine—a principle sound:  
 Vicious forces as passion, avarice, and greed  
 Are vehicles of progress the world doth need.<sup>15</sup>  
 The tempter must live to tempt, so let no one dare  
 Deprive the Yetzer-Ha-Rah of his major glare.

A brief examination of the foregoing will reveal its modern significance. In the fable the *Talmudic* sages were exploring the hidden springs of human existence. Accordingly, man is endowed with two diametrically opposed impulses.<sup>16</sup> These two "souls" within the human breast—the spiritual and the mundane, the virtuous and the vicious—both are designed so as to compete constantly with one another.<sup>17</sup> Both contend for a reward—one in the realm of the material, the other in the domain of the spiritual.<sup>18</sup> In the latter the "virtuous act" in itself may constitute the reward.<sup>19</sup>

To be sure, competition between the two natures is fierce, yet no dichotomy exists between the natural and the moral order. Nor is there a demarcation line between the holy and profane. Paradoxically, the complete attainment of moral perfection, in the light of this parable, poses a serious problem. Should pure "virtue" manage to render natural "vice" impotent, it may well destroy in the process an indispensable equilibrating force in the universe. Thus, benevolence and passion, righteousness and wickedness,<sup>20</sup> ignorance and erudition, darkness and brilliance,<sup>21</sup> etc., though essentially forces of a polarizing nature, nonetheless meet at some point and overlap in some mysterious fashion.

<sup>15</sup> *Midrash Tehilim* Buber ed., (Jerusalem: Brothers Rom, 1967), ch. 37, p. 272: "... God said . . . were it not for '*Kinab*' the world could not exist since no one would marry or build a house. . . ." The term "*Kinab*" connotes jealousy, envy, passion, emulation. It is akin to "greed," "appetite," and "ambition.") The implication of this statement is that man was to behave in a moderately "vicious" way that is socially expedient. . . .

<sup>16</sup> *Babyl. Talmud, Brakhot* 61a. "... Two passions did God create, the good and the bad. . . ." The term "yetzer" or "inclination" is derived from the Biblical "vayitzar" (Gen. 2:7) with two vowels. From this it was inferred that God "fashioned" man with "two natures."

<sup>17</sup> *Babyl. Talmud, Brakhot* 5a.

<sup>18</sup> *Ibid.*, 61b.

<sup>19</sup> *Babyl. Talmud, Abot* IV. II. "The reward of a good deed is the deed itself." Although divine retribution was taken for granted by the rabbis, they insisted that it should not serve as a primary motive for virtue; rather should a good deed be considered its own reward.

<sup>20</sup> *Op. cit.*, *Brakhot* 61b. "... The world has been created only for the wholly wicked or wholly righteous (to be enjoyed.)"

<sup>21</sup> *Zohar, Tazria* 47. "Were it not for the existence of ignorance there would be no erudition. . . ." "Without wickedness there would be no conception of righteousness" just as "brilliance could hardly be conceived without darkness." The *Zohar* or "Splendor" is a kabalistic work which, among others, deals with mystical psychology. It is based upon discussions of a group of 2nd century rabbis. See also, *Talmud, Haggiga* 15a, "Whatever God created, He also created its counterpart."

In the light of this approach, that which was heretofore considered "evil" or morally debasing, is now viewed simply as an "impulse" or natural instinct, without the adjective that prefixes it. In itself it is neither bad nor good but neutral, depending on how the impulse is utilized by man.

## II

## Comparative Analysis and Evaluation

THE STUDENT OF ECONOMIC THOUGHT will easily notice the existence of a close affinity between the philosophical trend of 18th century economic liberalism and the "economic theology" expounded in the *Talmud*. Indeed, there seems to be a remarkable similarity between the *Talmudic* fable and Mandeville's famous satirical poem "The Fable of the Bees."

To begin with, in both the *Talmud* and in Mandeville's fable is the remarkable paradox that

Parties directly opposite  
Assist each other as 'twere for spite.<sup>22</sup>

The apparently discordant passions strangely harmonize to the end that "private vices" are turned into "public benefits." To substantiate this assertion, Mandeville leads us through the tortuous avenues of the realistic world of merchants and lawyers, priests and judges, moralists and politicians who, according to him, are all vicious. And yet, their wickedness forms the stuff out of which the complicated social mechanism is composed.

Millions endeavoring to supply  
Each others' Lust and Vanity . . .<sup>23</sup>  
Thus every Part was full of Vice,  
Yet the whole Mass a Paradise.<sup>24</sup>

Accordingly, all material civilization is the product of vices gratified and not the fruit of virtue. Since the *results* of man's actions are usually beneficial and agreeable to society, it is the consequences of those actions and not the motives that count.<sup>25</sup>

Mandeville further amplified the views he expressed in his doggerel poem in a series of subsequent prose essays. In these he explained "how

<sup>22</sup> Mandeville, *op. cit.* Also *The Grumbling Hive* (Oxford, England: Clarendon Press, 1924), p. 25. For more about Mandeville, see J. C. Maxwell, "Ethic and Philosophy of Mandeville," *Philosophy*, Vol. 230 (1926); also the article on Mandeville in the *Encyclopedia of the Social Sciences*, Vol. X, pp. 93-4. Also N. Rosenberg, "Mandeville and Laissez Faire," *Journal of the History of Ideas*, Vol. 24, No. 2 (1963).

<sup>23</sup> *Fable, op. cit.*, i. 18.

<sup>24</sup> *Ibid.*, i. 24.

<sup>25</sup> Unlike Mandeville, it is the general consensus of the *Talmudic* rabbis that man has the capacity to act from pure motives.

necessary our appetites and passions are for the welfare of Trade and Handicraft," and how "Avarice and Prodigality are equally necessary to society."<sup>26</sup> He also reasons that in the final analysis ". . . a Passion in our Nature . . . may be Good or Bad according to the Actions perform'd . . ."<sup>27</sup> The logical conclusion therefrom was that economic advancement would be increased by giving free play to the selfish motive of the individual. The vice of selfishness would spur each person on to maximize his gains and thereby add to the wealth of the nation.

It should now be obvious that both the *Talmudic* parable and Mandeville's fable are fundamentally in agreement, particularly in their psychologizing of economic phenomena. Both view the natural impulse as a constructive force which contains the important ingredient of social utility.

The *Midrash* endeavors to demonstrate the degree of social utility that is inherent in the natural impulse by differentiating between the "good" and the "very good" impulse. The latter, according to the *Midrash*, refers to the "evil passion." "But can the evil passion be *very good*?" they wondered. Yes! because, were it not for the evil passion, no one would marry, neither build nor engage in business, and the world could not exist."<sup>28</sup> It is remarkable that in this *Haggadic* rendition the "evil" or natural instinct is placed on a much higher plane than the good impulse, apparently on account of its "utilitarian" function.<sup>29</sup> If we were to put the basic *Midrashic* motif into the modern idiom, we could perhaps do so best by quoting Mandeville's words:

Envy itself and Vanity  
Were Ministers of Industry."<sup>30</sup>  
"As Pride and Luxury decrease  
So by degrees they leave the Seas . . .  
All Arts and Crafts neglected lie;  
Contend, the Bane of Industry  
Makes 'em admire their homely Store  
And neither Seek nor Covet more."<sup>31</sup>  
"Fraud, Luxury and Pride must live  
While we the Benefits receive."<sup>32</sup>

<sup>26</sup> *Ibid.*, Remarks, p. 250.

<sup>27</sup> *Ibid.*, p. 74.

<sup>28</sup> *Kobelt Rabba* 4:4.

<sup>29</sup> The term "utilitarian" is employed here in the broader sense, meaning useful to society as a whole.

<sup>30</sup> *Tahle at . . .* = 25, 1, 11.

<sup>31</sup> *Ibid.*, i, 34-5.

<sup>32</sup> *Ibid.*, i, 36-7.

To summarize, man's propensity to marry, truck and build, is, in the light of the *Talmudic* parable, a product of the natural impulse. The forces of passion, ambition and greed, etc. are accordingly, indispensable instruments or "utilitarian" vehicles which maintain the world in an operational balance and keep civilization advancing. Three points of modern significance emerge from our analysis of the *Talmudic* fable:

1. "Virtue" without "vice" would necessarily be counter-productive.
2. Within the diversity of man's motives, there is uniformity of design.
3. An *operational balance* exists which harmonizes individual efforts with the interests of society.

It has been widely recognized that the selfish motive lauded by Mandeville became the basis of the next great economic theory—Economic Liberalism.<sup>33</sup> It culminated when Smith cut the Gordian knot of Mandeville's virtue-vice paradox by saying in effect, that if men, following their natural inclination, generally acted in the public interest, then their actions cannot be called vicious. The "vices" must somehow be "virtues." This, then, was the philosophical basis for his eloquent espousal of *laissez-faire*. Thus the *Talmudic* conception of "vice" and "virtue" seems to be in general agreement with the same postulates and therefore may well qualify as a precursor of the modern economic philosophy of *laissez-faire*.

### III

#### The "Other-Directed" Theory of Human Action

NOW THAT THE MEANING of what may be defined as the "instinct-emotion" center of existence and its equilibrating nature have been analyzed, we shall attempt to examine the conscious motive, or man's *creative* drive in the light of *Haggadic* literature. Here again, we hope to demonstrate the remarkable affinity between Adam Smith's doctrine of the "Invisible Hand" and the *Talmudic* conception of a guiding spirit that makes for economic interdependence.

This concept is presented in a *Midrashic* statement. Inasmuch as the *Talmudic* writers saw life's phenomena within a religious framework, they considered Providence as the force behind man's creative drive. Thus, they portray Providence calling upon Israel to plant and build:

. . . Even though thou mayest find the land prosperous, thou must not recoil saying: I shall relax and refrain from planting. . . . Just as thou hast found plantations what others have established before you, thou must

<sup>33</sup> See A. Chalk, "The Rise of Economic Individualism," *Journal of Political Economy*, August, 1951, p. 347: ". . . There is much justification for F. B. Keye's assertion that Mandeville's Fable of the Bees is the first systematic presentation of the Laissez-faire philosophy . . ."

do the same for posterity. . . . Do not say . . . why should I labor for others. . . ?<sup>34</sup>

Then comes the moral with a psychological explanation:

. . . Were it not for the concealment of death from man's heart, he would neither build nor plant, claiming "tomorrow I die, why should I toil for others?" Therefore has Providence concealed from man the day of his death so that he would continue to build. . . . Now if he be worthy he himself will be the beneficiary; if not, he will serve as a benefactor "L'Ahayrim," "to others."<sup>35</sup>

I shall consider the two parts of the statement separately. In the first part, Providence—as it were—prods man to rationalize his economic efforts, as if saying, "How much less fortunate would you be without your ancestor's sweat and toil; you in turn must do the same for the coming generation. . . ." It is then the awareness of the inevitability of man's economic dependence that prompts him to "build" and "plant." His creative effort inspired by Providence is thus a product of a social force based on a legitimate, intelligent self-interest—a concept generally advanced by Francis Hutcheson<sup>36</sup> (1694–1747), a teacher and forerunner of Adam Smith.

In the second part of the statement, the *Talmudic* scholars seem to have translated this phenomenon from economics to psychology, implying that man is basically a selfish creature. Were it not for his real or imaginary expectations of comfort and pleasure, he would certainly refrain from any creative endeavor. If he does engage in economic activities, it is because he is motivated by economic self-interest. But here comes the essence of the *Talmudic* doctrine: if he merits, he himself will enjoy the fruit of his labor; if not, "*L'Ahayrim*," he will then become society's benefactor. Whether he is the beneficiary or the benefactor, in either case he is motivated by self-interest. But meanwhile his "selfish" ambition makes him an unconscious contributor to "others" and thus to the general welfare of mankind. This process amounts, perhaps, to the earliest "other directed" theory of human action.

Two points of special significance emerge from this *Haggadic* exposition:

1. Emphasis is placed upon man's sympathetic feelings toward society—to promote harmony in human relations.

<sup>34</sup> *Midrash-Tanbuma, K'doshim* 8, Horeb, ed. (Leipzig, 1927). Freely translated by the author from the original. *Tanbuma* is the oldest *Haggadic Midrash*. According to S. Buber, publisher of the oldest text (Vilna 1885), it antedates the *Babylonian Talmud*.

<sup>35</sup> *Ibid.*

<sup>36</sup> See *An Inquiry*, *op. cit.* and the revised edition.

2. Self-interest provides the motivation of men's actions. In the first instance, man's conscience is prodded by Divine Providence to be concerned with the feelings and reactions of "others." Others have built before, how can one do otherwise? "Do not say, why should I work for others?" The emphasis, then, is on man's congenial feeling for promoting harmony in human affairs. The second, seems to advance the thesis that basically man is "selfish" but Providence has so arranged that out of this self-interest a social pattern develops which in the end benefits both the individual and society.

How does all this compare with modern economic thought? In answering this question let us first briefly summarize Smith's philosophy as presented in *The Theory of Moral Sentiments*. Its basic idea is that ethical systems develop by a natural process out of individual personal relationships. The individual decides that certain actions are proper or improper by observing the reactions of others to his behavior. A social consensus then develops that approves those patterns of behavior that benefit both the individual and society. Thus Smith's emphasis on the social force of "fellow feeling" corresponds to the first part of the *Haggadic* exposition of moral sentiments.

With regard to the second part, which puts emphasis on man's own interests as the motivating force, Adam Smith, too, in his *Wealth of Nations*<sup>37</sup> has abandoned his original thesis of "fellow feeling," insisting instead that a more simple self-interest furnished the motivation for men's actions. He enlists his powerful self-interest doctrine and points out that the individual continually exerts himself to find the most advantageous employment both for himself and his capital, and thereby brings the greatest benefit to himself and society. The individual:

. . . neither intends to promote the public interest, nor knows how much he is promoting it . . . ; he is . . . led by an invisible hand to promote an end which was no part of his intention. . . . By pursuing his own interest he frequently promotes that of society.<sup>38</sup>

Smith's strong conviction of a natural order which is reaffirmed again and again throughout the *Wealth of Nations* is very similar to the general *Haggadic* conception of Providence's scheme to interrelate the interest of the individual with that of society.

It is noteworthy that a *Haggadic* rendition of a Biblical exhortation to be charitable to the indigent (*Deut.* 14:22) amplifies this thesis. "Said

<sup>37</sup> *Wealth of Nations* refers to the two volume edition by Edwin Cannan which is a reprint of the fifth edition of *An Inquiry into the Nature and Causes of the Wealth of Nations* (London, 1904).

<sup>38</sup> *Wealth of Nations*, *op. cit.*, book I, p. 421.

R. Johanan, 'Aser B'shvil Sh'tisasher,' ("Thou shalt surely tithe in order that thou become rich.")<sup>39</sup> It is extremely interesting that Johanan, (whom I have shown elsewhere thought in modern economic categories),<sup>40</sup> in order to arouse man's generosity appeals primarily to his natural instinct—his acquisitive propensity, rather than to his sense of compassion. Smith, too, when speaking of man's acquisitive nature phrased it as follows:

. . . We address ourselves not to their humanity but to their self-love, and never talk to them of our own necessities but of their advantages.<sup>41</sup>

Finally, our analysis has brought to light the remarkable affinity that exists between the *Talmudic* parable and Mandeville's fable, and also between the *Haggadic* "other directed" theory of human action and Smith's philosophy of economic liberalism. The implications and ramifications of these doctrines can well be summarized in the words of Gide:

Smith criticised Mandeville in his *Theory of Moral Sentiments*. But despite his criticism, Mandeville's idea bore fruit in Smith's mind. Smith in his turn was to reiterate the belief that it was personal interest (in his opinion, no vice, but an inferior virtue) that unwittingly led society to the path of well-being and prosperity. A nation's wealth for Smith, as well as for Mandeville, is the result, if not of a vice, at least of a natural instinct . . . which is bestowed upon us by Providence for the realization of ends that lie beyond our farthest ken.<sup>42</sup>

This summary is applicable also to the social doctrines of the *Talmud* and their relation to both Mandeville and Smith. The *Talmud* has anticipated both Mandeville's and Smith's emphasis upon natural order, the ubiquity of self-interest and the identity of public and private interests.

Whether the social and economic doctrines contained in *Talmudic* literature ever had a direct or indirect influence upon the 18th century philosophers of moral sentiment and modern economic thought, remains to be investigated.

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<sup>39</sup> *Babyl. Talmud Taanit*, 9a. Appears also in *Shabbat*, 119a.

<sup>40</sup> "Economic Thought in Talmudic Literature," *op. cit.*, pp. 194-6.

<sup>41</sup> *Wealth of Nations*, *op. cit.*, book I, p. 16.

<sup>42</sup> Charles Gide and Charles Rist, *A History of Economic Doctrines* (London: D. C. Heath and Co., 1913), p. 72.

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[Announcement from Valentina Borremans, executive director, CIDOC.]

# Rabbinical Responsa and the Regulation of Competition

By AHARON SHAPIRO

## I

A NEGLECTED AREA in studies of the history of economic thought and economic history is the economic thinking of the semiautonomous Jewish communities of Europe from the 16th through the 19th centuries. Though the Jews of this period were subject to considerable oppression and discrimination, they were usually allowed to regulate their own internal economic and social affairs. The Jewish communities gratefully accepted this privilege, since they were reluctant to settle their problems by turning to the generally biased and often corrupt secular courts and officialdom.

Since many aspects of Jewish life tended to be governed by religious law, the Jewish community naturally resorted to the sacred literature of the Bible and *Talmud* for precedents in controlling economic activities. The rabbi of the community, who was appointed to his position because of his religious scholarship, served as judge and regulator of business activity. His decisions on cases presented before him for adjudication were binding in as much as they were backed by effective power to ostracize any recalcitrant parties.

With the advent of printing, many decisions were recorded in works generally known as *rabbinical responsa*. Unfortunately, all these legal briefs were written in an archaic legalistic Hebrew-Aramaic, which was, and still is incomprehensible to all but a few scholars. Furthermore, those who understood the technical language often failed to appreciate that the highly refined thinking of these rabbis on many subjects could be of import and significance to the scientific disciplines of the modern world.

This paper is concerned with only one of the many topics discussed in the thousands of volumes of extant rabbinical responsa, namely, the regulation of competition in the Jewish community.

## II

TO UNDERSTAND why these communities needed such regulation, one must appreciate how limited were the economic opportunities of the Jew. Rarely could he own land. The guilds withheld membership in the crafts from him. Specially imposed travel restrictions kept him from engaging in wide-ranging commerce. At best he could pursue a livelihood as a shop-

keeper and middleman. This made the franchises granted by gentile officialdom for the exclusive sale of various commodities extremely valuable.

The Jewish community treated the holders of these franchises, and for that matter all Jewish merchants, as having a right to trade only by consent of the community. Whenever the interests of the community were in conflict with those of the individual, the will of the community prevailed. For this reason, unrestricted competition for these government franchises was not permitted lest intense bidding unduly raise the award prices and cause a lessening of the total income and welfare of the communities. Similarly, competition among merchants was regulated, particularly for those seeking new entry into a field who might threaten the marginal livelihood of a merchant already engaged in it.

The rabbis could not tolerate the operation of rugged competition which is supposed to promote the shifting of resources into the most productive lines while weeding out the least efficient producers. First, the economic horizons for all enterprise were very limited and the displaced would have no other opportunities. Furthermore, the loser in the competitive race was not an insentient, unfeeling business corporation but rather an impoverished suffering human being. The rabbinical scholars therefore modeled a framework within which competition would be tolerated. They sought these ground rules in the source of all Jewish conduct in those days, specifically, the Bible with its *Talmudical* exposition.

### III

THOUGH HE WAS NOT THE FIRST to expound upon the principles governing economic competition,<sup>1</sup> Benjamin Aaron Slonik was perhaps the first to write so lucidly and broadly about them. He lived in Poland from about the year 1550 to 1619 and served as rabbi of the communities of Grodno and Podheiz. He is best noted for his master work *Massa'at Binyamin* containing 112 responsa on a variety of questions of Jewish law. His responsum on competition became the basis for most discussion on the matter in all later rabbinical works.

Slonik develops four tests by which disputes over competition are categorized and adjudged. Sanctions and punishments are meted out in accordance with the test that best applies to a particular case. The source for these tests are Biblical and *Talmudical*.

<sup>1</sup> Solomon Luria, *Responsa* (Lublin, Poland: 1574), No. 36, an early exposition on competition similar to Slonik. (All sources are in untranslated Hebrew.)

<sup>2</sup> Benjamin Aaron Slonik, *Massa'at Binyamin* (Wilno, Poland: 1894), No. 27 (1st ed. Cracow, Poland: 1632).

When Party *B* enters and competes with the established business of Party *A* the following tests apply:

*Test I*

Does the present entrepreneur Party *A* owe his economic advantage to mere windfall and fortuitous circumstance?

Sanctions against *B*. None. *B* is free to compete without penalty.

*Test II*

Did *A* enter into an oral agreement with third party *C* on any business transaction before *B* came onto the scene with a competitive bid? Sanctions. *B* is not required to restore the property or privilege taken from *A* but must suffer the not inconsequential humiliation of being publicly denounced in the community synagogue as being a "wicked man." This could mean considerable economic harm in the future. By way of clarification, Jewish law does not recognize oral agreements as technically binding. Transactions for movable property become final in most cases only when the new owner actually causes a physical movement of the object. The transfer of money alone is not sufficient. Real estate reverts to a new owner only by a) transmission of payment to the seller b) by issuance of a deed to the purchaser or c) by the purchaser making some physical change in the property such as the beginning of the construction of a fence.

*Test III*

Did Party *A* undergo considerable expense in time, effort or money in order to acquire his economic advantage before the appearance of competitor *B*?

Sanctions: *B* is deemed a "thief" but only according to *Talmudical* rules and not Biblical rules of theft; the distinction is that in a case of *Talmudical* theft, the rabbinical courts will not force Party *B* to return the property or privilege to *A*. However, *A* may now use any competitive measure at his disposal to effect the return of his property or privileges without any concern for the economic welfare of *B*.

*Test IV*

Will competition from *B* be ruinous to *A*?

Sanctions: Under this crucial test, such competition is treated as Biblical theft which means that the rabbinical courts can force *B* to restore all property and privileges expropriated from *A*.

From actual cases before Slonik and others where the above tests were applied, the reader should obtain some idea of how economic competition was controlled in these segregated Jewish communities.

The following is a paraphrase of a Slonik decision:

Party *A* operated a special liquor sales franchise for 10 years. He was later coerced into accepting a non-Jew as a partner. After some time,

the non-Jew sought to extract even better terms of partnership from *A* by threatening to bid away the franchise from *A* entirely and, in fact, foolishly made such a bid to the officials although he lacked funds. To his dismay, the officials accepted his bid. But since the non-Jew was unable to produce the cash to confirm his bid, he was fined a large sum by the government official.

In need of cash, the non-Jew agreed to sell out his share to his partner, Party *A*. An oral agreement was reached although the price was not defined. Meanwhile, Party *B* interceded and purchased the non-Jew's share at a price much higher than the non-Jew would have likely paid *A*. Party *A* sued for return of his former partner's share since he had been unjustly deprived of it by the non-Jew in the first place and since he had already made a verbal agreement with the partner to buy back the share and, finally, since the community already had an ordinance forbidding a fellow Jew from bidding for a franchise from which a Jew had been forcibly vacated. The Jewish community adopted such self-protective devices to counteract the promiscuous awarding and withdrawing of the franchises by secular government officials.

Slonik decided in favor of Plaintiff *A* and ordered the restoration of the second share to him. Reviewing the four tests, Slonik notes that our case goes beyond the criterion of Test I, since Party *A*'s control of the liquor franchise was no mere windfall but involved considerable expenditure of effort and money. This would make our case subject to Test III which however does not carry with it any court-enforceable penalty. Test II involving oral agreement violations also does not apply since the verbal agreement should have a specified price which it did not in our case. However, Slonik did decide that Test IV had been met. Party *A* had been forced into a ruinous situation by the non-Jew who had pressured him into partnership. Party *B*, by preventing *A* from recovering his lost share of the business was perpetuating the ruination and therefor is subject to the sanctions of Test IV which permits the rabbinical courts to order the restoration of all property to the original owners.

Slonik's principles were published and circulated and soon became the basis for many of the decisions of the rabbinical courts throughout Europe. Underlying all this regulation is the theme that the individual is best served when the interests of the community as a whole are best served. Although the general principle was followed that when an individual operated a franchise for three straight years, no competitor was permitted to bid away the franchise, this rule did not apply to the overriding power of the community to reallocate the franchise at its discretion even to the injury of particular individuals.<sup>3</sup>

<sup>3</sup> Joel Sirkish, *Bayit Chadash* (Poland: 1673), No. 60.

IV

BY THE SAME TOKEN, a community was responsible for the welfare of the holder of a franchise received through the community. Moses Sofer (1763–1840) decided that when the concession holder of a slaughtering house suffered a loss due to unforeseen circumstances, the community must share some of the loss. This occurred when the German government flooded the lamb market in a distress attempt to dispose of sheep being struck down by a plague.<sup>4</sup>

When the community forbids competition as in a case involving clothing merchants, not even the merchants as a group have a right to waive the restriction and indulge in price competition. The reasoning is that although a businessman ruined by competition may have a right to waive financial damages, he does not have the right to waive the basic moral and religious wrong perpetrated by an overly vigorous competitor.<sup>5</sup>

There were of course many exceptions where competition was permitted. If lower prices would benefit the community without ruining individuals, competition was encouraged. One anecdotal case, however, prohibited the cutting of prices for tavern beverages, on the grounds that Jews were not frequenters of taverns and therefore the community would not benefit.<sup>6</sup>

Noteworthy exceptions were made to allow for competition for educational and religious teaching purposes. Reprints of Biblical and *Talmudical* works were not granted exclusive and indefinite copyrights on the grounds that it was in the interest of the community to disseminate the literature as inexpensively and as abundantly as possible.<sup>7</sup> Similarly, schools and families were permitted to compete freely for teachers' services, since this would raise the value and standards of the professional teacher.<sup>8</sup>

THIS PAPER HAS PRESENTED but a few summaries of many similar cases to be found in the responsa literature on this subject. The literature remains to be explored more fully, not only in regard to competition but with respect to a wide variety of other economic topics such as taxation, interest-taking, inheritance, etc.

Does the subject matter have any transference and application to mod-

<sup>4</sup> Moses Sofer, *Chatham Sofer* (Wilno, Poland: 1864), No. 161.

<sup>5</sup> Yair Bachrach, *Chavat Yair* (Lemberg, Poland: 1694), No. 163.

<sup>6</sup> Meir Eisenstadt, *Panim Me-irot* (Amsterdam: 1705), Vol. I, No. 78.

<sup>7</sup> M. Schneirsohn, *Zemach Zedek* (Wilno, Poland: 1871), Vol. Yoreh Deah No. 195.

<sup>8</sup> Sofer, *op. cit.*, No. 79.

ern economic thinking or is this merely a study of a bygone society? My own belief is that the thinking of the responsa period has present-day value.

Economic science has been content over the past two centuries to be designated as an amoral discipline. The forces of competition, we have argued, are neither moral nor immoral but rather, left unfettered, will promote the greatest good and well-being for all. In more recent times we have become painfully aware that unregulated competition often deteriorates into unregulated oligopoly and monopoly. We have become more acutely conscious of the need for surveillance and perhaps regulation of our industrial giants. The economics of the market place will have to be supplanted gradually by the economics of regulation. More and more frequently economic science will be called upon to establish goals that are more in consonance with the interests of the community and the nation rather than with those of the individual proprietor or corporation. The responsa literature, with its emphasis on the welfare of the community, should offer considerable help in this direction.

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### *Work with the Aged*

OLDER PEOPLE are the poorest and most neglected group in our society, according to a specialist in work with the aged.

"Of the 18 million Americans over 65, more than one million live in abject poverty," said Dr. Louis Lowy, of Newton, Mass., professor of social work at Boston University, "and more than seven million are poor."

He pointed out that approximately 2.5 million couples in this age bracket have incomes under \$3000 a year, and 2.7 million single people have incomes under \$1500 a year.

Dr. Lowy is the author of the first manual to train personnel to work with the elderly. The two-volume *Training Manual for Human Service Technicians Working with Older Persons*, was published jointly in 1968 by the United Community services of Boston and the University's School of Social Work.

# The Tax System of Ethiopia

By PETER SCHWAB\*

IN 1966 EMPEROR HAILE SELASSIE I of Ethiopia promulgated by executive decree a new tax law. Though there is no constitutional distinction between bills subject to parliamentary legislation and those subject to executive declaration, parliamentary ratification has been, and continues to be, the basis for legitimizing and institutionalizing the political system. Despite the fact that the bill is already law, it is not yet in effect. The previous tax laws will continue in force until parliament approves the 1966 executive decree.

Parliament began debating the tax reform bill in the summer of 1967. The bill would abolish all taxes presently in existence with the exception of the income tax. The rationale behind this recommendation is to weaken the landed aristocracy which has continually managed to avoid paying the bulk of their taxes. In place of the present system a progressive income tax would be instituted upon the entire population, with the exception of the nomads who would pay a head tax on their cattle.

Both Houses of Parliament, the Senate, and the Chamber of Deputies, must approve it. The Senate, appointed by the Emperor, and the Chamber of Deputies, elected by universal suffrage, have rarely acted independently of Haile Selassie. Yet, in this case innovation tends to arouse passionate opposition. Because many of the members of parliament are the land-owners affected by this bill, their reaction is not surprising.

Though it would not be impossible to dissolve parliament if the legislature remains intransigent, it seems more likely, in terms of legitimization that the Emperor will await the 1969 balloting when a new Chamber of Deputies will be elected. Using enormous influence the Imperial Palace and the Emperor himself may obtain the nomination and election of individuals sympathetic to the tax reform bill. Because the tax proposal is almost revolutionary (and needs to be recognized as such) it would seem obvious that the Emperor would move slowly and steadily as he has in the past.

## I

THE POLITICS OF TAXATION becomes evident when one recognizes that the Emperor's major political support comes from those groups directly

\* The author thanks L. Gray Cowan of Columbia University and Gwendolen M. Carter of Northwestern University for their helpful comments and criticism; and Eric Broudy for his editorial assistance.

affected by the bill: The Ethiopian (Coptic) Christian Church and the landed aristocracy. Not only are many of the landlords in parliament, but they are entrenched in the upper echelons of the bureaucracy, and hold positions in provincial government. The Emperor, in substituting modern for traditional norms of legitimacy, places himself in direct opposition to these two powerful institutions. It will be interesting to see whether the 1969 legislature will act more in accord with Haile Selassie's demands. It is certainly quite possible, since the maintenance of the legislators' own power is at stake, that even the authority of the Emperor will not suffice to reform the present system of taxation.

In 1934 the late Gerhard Colm in an article on "The Ideal Tax System," summarized and discussed the different stages of taxation which conform to the various stages of capitalism. He wrote that in the earlier stages of capitalistic development:

the social-critical ideology . . . seeks to establish a tax system which . . . taxes the rich more heavily than the poor. . . . For the social state the progressive income tax is regarded as conforming most closely to the demands of an ideal tax system.<sup>1</sup>

Though Colm argues that each stage of taxation is interrelated to the other stages it would seem that presently in Ethiopia Haile Selassie has, for political, administrative and economic reasons, decided upon the 'social-critical' type of tax system as a replacement for the multiplicity of taxes which have been in existence since 1942. At present Ethiopia has essentially three different tax structures. In essence there exist: (1) a central government tax system; (2) a local or provincial tax system, and (3) a system of church taxes, independent of and not controlled by the government. (The provincial tax is in effect the same as a central government tax. The difference is that it is collected locally and then sent to the central government, unlike the central government tax which is paid directly into the treasury.)

The central government's ordinary revenue comes from both direct and indirect taxes, the latter bringing in the larger amount. In Fiscal Year (FY) 1965/66 indirect taxes accounted for E\$110.9 million, and direct taxes E\$60.3 million.<sup>2</sup> The direct education tax, health tax, and cattle

<sup>1</sup> Gerhard Colm, "The Ideal Tax System," *Social Research*, Vol. 1, No. 3 (August, 1934), p. 327ff. Though Colm analyses much of the literature relating to a single tax on income it must be remembered that he was writing about the Western world. One must be careful in transposing the model to the developing world. An equally relevant discussion, relating to taxation and social change and emphasizing the non-Western world, is found in Part One of United Nations Document ST/TAA/M/8 "Taxes and Fiscal Policy in Under-Developed Countries" (1954).

<sup>2</sup> Imperial Ethiopian Government, *Ethiopia-Statistical Abstract*, (Addis Ababa: Central Statistical Office, 1965), p. 141.

tax together accounted for only E\$10.5 million in the same year. The health and education taxes, and the two provincial taxes, are later reallocated to the provinces for their own use. This redistribution is controlled by the relative needs of the various provinces and the amount of revenue collected. In some years not all the collected money is returned to the provinces, and in other years more is returned than is collected. The health

Table 1  
GOVERNMENT REVENUE BY SOURCE, FY1965/66  
(Eth. \$ Million)  
ORDINARY REVENUE

<i>Direct Taxes</i>	
Income Tax	33.8
Land Tax	5.5
Tithe on Land	10.5
Education Tax	5.0
Health Tax	5.2
Cattle Tax	0.3
Total	60.3
<i>Indirect Taxes</i>	
Alcohol Excise Tax	17.0
Tobacco Tax	4.5
Stamp Duties	4.8
Transaction Tax	37.8
Excise Tax on imported and domestic goods	17.5
Salt Tax	5.8
Motor Fuel Tax	23.5
Total	110.9

SOURCE: Imperial Ethiopian Government, *Ethiopia-Statistical Abstract*. (Addis Ababa: Central Statistical Office, 1965), p. 141.

tax is collected at a rate amounting to 30 per cent of the municipal taxes on land, and the education tax amounts to 30 per cent of the sum of the land tax and tithe payable on the lands. The tithe is an additional tax on land which traditionally was paid in kind, but since 1942 is paid in cash. In 1954 the cattle tax was instituted. It called for each owner of cattle, goats, sheep, pigs, camels, horses and mules to pay a specific amount per animal (E\$1 per pig; 50 cents (Ethiopian) per camel; 25 cents per head of cattle; 25 cents per horse and mule; and 5 cents per goat and sheep.<sup>3</sup>) Money collected from this tax in FY1965-1966 equaled 0.3 million.

<sup>3</sup> *Negerit Gazeta* (14th Year, No. 1) (Addis Ababa: Berhanuena Selam Printing Press), Sept. 30, 1954.

## II

THE TWO BASIC FORMS of direct taxation levied by the central government are the land tax and the income tax. The first land tax was announced on October 11, 1941 in the Land Tax Proclamation. All land in the State was divided into three categories: fertile, semi-fertile, and poor. For each gasha (forty hectares) of fertile land a E\$15 tax was levied; for semi-fertile land E\$10 was charged; and for poor land E\$5.<sup>4</sup>

The revised Land Tax Proclamation of 1944 allowed certain exemptions from the land tax. Excused from payment were holders of Rist-Gult, Siso-Gult and Samon.<sup>5</sup> Both Siso- and Rist-Gult were traditional exemptions in which "the government allocated to the first tiller of the soil a quarter, or a third, or even more of the land which he had cultivated."<sup>6</sup> This meant that the original landowner was not liable for paying a land tax.

Since many of the large landholders were the original landowners, a monied sector of the economy was relieved of paying any land tax. In 1966 a proclamation was issued abolishing Siso- and Rist-Gult.<sup>7</sup> Though this was an extremely important innovation, the traditional concept of Siso- and Rist-Gult could not be so easily broken down. It will take many years before the 1966 proclamation realistically can be implemented.

A Samon exemption refers to the church. The Ethiopian (Coptic) Christian Church, which owns between 25 and 33 per cent of the land in the country, leases land requiring the lessor to pay an annual rental. Because the church pays no taxes at all to either central or provincial government (Decree No. 2 of 1942)<sup>8</sup> it may keep the revenue it receives from the leasing program. In FY1961/62 the total rentals paid to the church were E\$1,981,148.<sup>9</sup> The central government exerts no manifest pressure upon the church to allocate any of its receipts. Subtle pressure does emanate from the Imperial Palace, but the methods of pressure are kept secret. Command of revenue derived from leasing elevates the church to an economic power as well as a social and cultural power.

However, weaknesses in the tax structure other than the above exemptions make the land tax less of a capital source than it appears. As a Ministry of Finance document declares:

<sup>4</sup> Gabre-Weld-Ingida Worq. "Ethiopia's Traditional System of Land Tenure and Taxation," *Ethiopia Observer*, Vol. 5, No. 4 (1962). Translated by Mengesha Gessesse from the book *Ya Ityopya Maretna Gibir Sim*, p. 328.

<sup>5</sup> *Ibid.*, p. 331.

<sup>6</sup> *Ibid.*, p. 304.

<sup>7</sup> *Negarit Gazeta* (25th Year, No. 9), March 7, 1966.

<sup>8</sup> Ministry of Finance, Ethiopia, *Land Tax in Ethiopia-Summary*, 1964, p. 9.

<sup>9</sup> *Ibid.*, appendix B.

It is clear from the land tax proclamation that the landowner is the person liable to pay land tax. It is quite clear that the intention of the legislation was that the burden of taxation should fall not on the farmer, but on the landowner only. This intention however, has not been implemented. In Ethiopia, this shifting of the tax burden (from landowner to tenant farmer) has been tolerated by the government for many years. . . . It results in anomalies at the expense of tenants between landowners who farm the land themselves, and landowners who let it out to tenants. The custom would appear to penalize farmers, both owner farmers and tenant farmers, and to favor absentee landlords.<sup>10</sup>

Interviews also testify to the fact that many large landowners flatly refused to pay the tax. A few were arrested, but for political reasons they were not convicted and fined as Article 5 paragraph 1 of the 1941 Land Tax Proclamation demands. Despite the fact that Ethiopia's economy is basically agricultural, 1965/66 revenue from land taxes brought in only E\$5.5 million. This is partially compensated by the tithe on land which brings the government additional revenues totaling in FY1965/66 E\$10.5 million. The rates for the tithe on land are E\$35 per gasha of fertile land; E\$30 per gasha of semi-fertile land; and E\$10 per gasha on poor lands.

One criticism of this system is found in the report prepared by the Ministry of Finance.

It must be accepted that the present system of classification . . . is crude. The ideal would be to calculate the effect of all the various factors, particularly soil potential, but also climatic conditions. . . . In general the number of categories of classification is only three, whereas differences in factors affecting the land's potential in different parts of the country obviously point to the need for wider categorization.<sup>11</sup>

Another criticism of the land tax system in the same report is:

For reasons which are not fully apparent lower rates are charged on unmeasured lands than on measured lands, resulting in an appreciable loss of revenue to the government.<sup>12</sup>

The total land area of Ethiopia is deemed to be 3,070,750 standard gashas; 30 per cent of this is deemed to be uncultivable; after deducting from the remaining figure the 380,344 gashas already measured and taxed, a balance of 1,685,071 gashas remains. If this balance was taxed at the rates now in force for measured lands it would bring in approximately E\$131,600,000 if all the balance was fertile; E\$104,000,000 if all the balance was semi-fertile; and E\$37,000,000 if all the balance was poor land.<sup>13</sup>

<sup>10</sup> *Ibid.*, p. 6.

<sup>11</sup> *Ibid.*, p. 18.

<sup>12</sup> *Ibid.*, p. 1.

<sup>13</sup> *Ibid.*, p. 11.

It seems quite clear from the figures available, and from the Ministry of Finance report, that in addition to the inequities of the land tax a large amount of revenue is wasted since the system of calculation "is crude."

## III

THE LARGEST AMOUNT of income from direct taxes comes from the income tax. This was officially introduced to Ethiopia in 1943, although from 1941 to 1943 the income tax policy systematized by the Italians had been in operation. The present income tax system is based on a series of schedules. Under Schedule A the levying, charging, collecting and payment of tax on income from employment "is charged and collected monthly, including without limitations, salaries, wages, allowances, pensions, director's fees, and other personal emoluments."<sup>14</sup> The tax on income from employment, though collected monthly, is actually imposed on the income of the preceding month.

Under Article 8 of the Income Tax Proclamation "taxable income from employment shall include all payments in cash and all benefits in kind unless our Minister of Finance shall by regulations exclude certain

Table 2  
INCOME TAX RATES

<i>Taxable Income Per Month</i>	<i>Tax Per Month</i>	
(Eth. \$)	(Eth. \$)	(Per Cent)
0-30	Nil.	
30-40	0.75	
40-50	1.50	
80-100	3.75	
100-125	4.75	
175-200	9.00	
250-300	18.00	
350-400	27.00	
400-450	31.50	
600-650	52.50	
650-700	60.00	
750-800		10 p.c.
800-850		10.5 p.c.
900-950		11.5 p.c.
950-1000		12 p.c.
1000-1075		13 p.c.
3125-3750		18 p.c.
4375-5000		20 p.c.
5000 and up		21 p.c.

SOURCE: *Negarit Gazeta* (20th Year, No. 13), June 2, 1961.

<sup>14</sup> *Negarit Gazeta* (20th Year, No. 13), June 2, 1961.

categories of payments in cash or benefits in kind from income from employment."<sup>15</sup> This exclusionary power gains great importance since it means that the Minister of Finance may use his powers to aid others to avoid having income classified in certain taxable categories. An additional weakness in Schedule A, if one prefers a progressive tax system, is the relative regressivity of the tax rates.<sup>16</sup> This can be seen from Table 2.

Schedule B, "tax on income from rent of lands and buildings used for other than agricultural purposes,"<sup>17</sup> contains the rates in Table 3.

"A surtax of 10 per cent shall be charged on any part of the income which is in excess of E\$30,000."<sup>18</sup> Deductions of repairs, maintenance, and depreciation of buildings, furniture and equipment are permitted.

Schedule C refers to "tax on income from business, from professional and vocational occupations, from the exploitation of woods and forests for lumbering purposes, and for all other sources not elsewhere mentioned herein. . . ."<sup>19</sup> Such businesses are taxed at the rate of 16 per cent of profits, and those individuals so engaged are taxed at the rates in Table 4.<sup>20</sup>

Table 3  
REAL PROPERTY INCOME TAX RATES

<i>Taxable Annual Income</i> (Eth. \$)	<i>Tax Per Annum</i> (Per Cent)
0-360	Nil.
360-390	2
960-1800	3
1800-3000	4
3000-4500	5
4500-6000	6
6000-7200	7
7200-8400	8
8400-9600	9
9600-10800	10
10800-12000	11
12000-13200	12
13200-13800	13
13800-14400	14
14400-15000	15
15000 and up	16

<sup>15</sup> *Ibid.*

<sup>16</sup> *Ibid.*

<sup>17</sup> *Ibid.*

<sup>18</sup> *Ibid.*

<sup>19</sup> *Ibid.*

<sup>20</sup> *Ibid.*

In addition a surtax of 10 per cent is levied on any part of the taxable income which is in excess of E\$30,000, and an additional surtax of 10 per cent on any part of the taxable income which is in excess of E\$150,000. However:

In the case of a body incorporated in Ethiopia having a paid-up capital of E\$5 million or more, the limits for assessing the surtaxes set forth shall be increased by multiplying the limits of said surtaxes (E\$30,000 and E\$150,000, respectively) by the coefficient equal to one fourth of the number of complete millions of Ethiopian dollars of paid up capital.<sup>21</sup>

Table 4

## INCOME TAX ON BUSINESS AND PROFESSIONAL MEN

<i>Taxable Annual Income</i> (Eth. \$)	<i>Tax Per Annum</i>	
	(Eth. \$)	(Per Cent)
0-360	Nil.	
360-480	10.00	
480-600	18.00	
600-720	24.00	
1200-1500	57.00	
1500-1800	72.00	
1800-2100	90.00	
3000-3600	216.00	
4200-4800	324.00	
6000-6600	480.00	
6600-7200	552.00	
7800-8400	720.00	
9000-9600		10.0 p.c.
10800-11400		11.5 p.c.
13800-15000		15.0 p.c.

Certain categories of exemptions exist under Article 18, Schedule C of the income tax: (1) income from agricultural purposes; (2) income received by unskilled workers from employment by the day; (3) interest received by persons with bank accounts; and (4) income received by foreigners representing foreign businesses who do not remain in Ethiopia for 183 days in the aggregate. Under Article 19 industry which invests more than E\$200,000 before the commencement of their operations shall be exempted from income tax for a period of five years. Those industries which invest additional capital of more than E\$500,000 in the extension of their enterprise may be granted exemptions on the income derived from the extension for a period of up to five years. Income from the leasing of new buildings shall be exempt from the payment of income tax for a period of three years.<sup>22</sup>

<sup>21</sup> *Ibid.*<sup>22</sup> *Ibid.*

## IV

It is CLEAR that Ethiopia, while trying to encourage foreign investment, loses revenue by allowing substantial exemptions to that investment. In addition to losses sustained by the above exemptions it is estimated that, at most, only 75 per cent of income taxes in Schedules A, B and C is ever collected. The causes for non-collection are manifold. The outright refusal by some to pay, and the inefficiency within the bureaucracy of the Ministry of Finance accounts for some of the loss. However, the politics of landlordism is involved, and in this matter the modern political system must bow to the traditional ascriptive norms of Ethiopian politics. Collection is hampered also by the failure of employees to report that they have more than one employer. They thus avoid paying a percentage of their taxes. This practice continues because under Articles 38-41 of the 1961 Income Tax Proclamation too much flexibility exists in the income reporting and accounting procedure. As a result, out of a population of some 22 million people income tax revenue in FY1965/66 amounted to only E\$33.8 million.<sup>23</sup> The figures on the numbers of taxpayers are not presently available.

Governmental revenue from indirect taxes comes from an alcohol tax, excise taxes (on imported and domestic goods), a stamp tax, salt tax, and motor fuel tax, a tobacco tax, and a transaction tax.

The present tax on alcohol is based on a proclamation of April 1965. The tax is divided into two major schedules and one secondary one. The former deal both with taxable imported alcohol and with that manufactured within the Empire. In FY1963 governmental revenue from imported alcohol amounted to E\$1,200,000, and from locally manufactured alcohol E\$10,501,940.<sup>24</sup> In FY1965/66 total revenue returned by the alcohol tax amounted to some E\$17.0 million.<sup>25</sup> There are no exceptions to the alcohol tax except for homemade Tej and Talla, two traditional and popular Ethiopian drinks. The secondary schedule concerns the annual excise license that domestic manufacturers must purchase. A E\$500 excise tax is levied for a distillery of alcohol, E\$200 for the production of alcoholic liquor, and lesser amounts for the production of grappa, beer, stout, perfumes, and for Tej and Talla manufactured in factories.<sup>26</sup> One should note that whereas land tax in FY1965/66 brought in 1.5 per cent of ordinary governmental revenue, alcohol tax was 5 per cent of the total ordinary revenue.

<sup>23</sup> *Ethiopia-Statistical Abstract*, *op. cit.*, p. 141.

<sup>24</sup> *Ibid.*

<sup>25</sup> *Ibid.*

<sup>26</sup> *Negarit Gazeta* (24th Year, No. 10), April 22, 1965.

Excise Taxes on imported and domestic goods in FY1965/66 accounted for E\$7.5 million. According to the proclamations of 1963 and 1965 the three basic items taxed are sugar, yarn and textiles. The tax on sugar is E\$15 per 100 kilograms. Yarn is taxed at the rate of 15 cents per kilogram, and textiles at thirty-five cents per kilogram.<sup>27</sup>

Since the Minister of Finance is responsible for designating, specifying, implementing and enforcing this tax, and because the excise law is written very broadly and loosely, with the three exceptions mentioned above, he exercises a great deal of the power and responsibility himself. This concentration of power enables the wealthy and the powerful to exert the pressure needed to escape many of the taxes on goods he has specified.

The three taxes, stamp duty, motor fuel tax, and salt tax totaled in accumulated revenue for FY1965/66 approximately E\$34 million. The stamp duty subjects to payment promissory notes, bonds, contracts, insurance policies, leases, theatre tickets, petitions to government offices and the transfer of motor vehicles and trailers.<sup>28</sup>

A Tobacco Tax, which in FY1965/66 brought in E\$4.5 million,<sup>29</sup> is levied on imported tobacco, matches, cigarette paper and pocket lighters. Wholesalers of such products must pay a E\$40 tax per year; retailers in urban areas pay E\$12 a year, and retailers in other areas E\$4 per year.<sup>30</sup>

The largest amount of revenue collected from the indirect tax is the transaction tax proclaimed in 1963. This combines revenues from a tax on goods manufactured locally (a duty of 5 per cent), a turnover tax, and a tax on all construction work. Because of a conflict with other tax laws certain exemptions are made. Deductions in the amounts of excise taxes are permitted in the case of alcohol, sugar, cotton goods, yarn, salt and tobacco if manufactured locally.<sup>31</sup> In addition locally manufactured ice cream, coffee, tires, tailored suits and dresses are exempted from the tax.<sup>32</sup>

The turnover tax requires that "every trader shall pay the turnover tax on all sales made by him. . . ."<sup>33</sup> Since, however, the accounts are kept by the traders themselves without any meaningful governmental supervision, collections can hardly be efficient. The turnover tax is chargeable at the rate of one per cent of the amount of sales, paid on a quarterly basis. Tax on construction work is charged at the rate of 2 per cent of the cost

<sup>27</sup> *Ibid.* (24th Year, No. 15), July 16, 1965.

<sup>28</sup> *Ibid.* (17th Year, No. 4), Oct. 31, 1957.

<sup>29</sup> *Ethiopia-Statistical Abstract*, *op. cit.* p. 141.

<sup>30</sup> Ministry of Finance, Ethiopia, *Taxation in Ethiopia* (Addis Ababa), p. 7.

<sup>31</sup> *Negarit Gazeta* (23rd Year, No. 8), Jan. 30, 1964.

<sup>32</sup> *Ibid.*

<sup>33</sup> *Ibid.*

of the work. The total intake from the transaction tax in FY1965/66 was E\$37.8 million.<sup>34</sup>

Looking at the budget of the FY1965/66, it will be seen that there is a E\$25 million deficit. However, informal procedures, often of a particularistic and ascriptive nature, equalize this deficit to some extent. For example, the National Lottery of Ethiopia attempts to collect money for purposes of charity. (In 1967 the drive was for the construction of the St. Paul Hospital.) However, the approximately E\$1 million that is raised each year by the lottery is used to lessen the deficit in the budget. Revenue is also collected on an informal basis by the Emperor's appeal both to landlords and the hierarchy of the Ethiopian Coptic Christian Church. Whether this is an appeal or a demand is to a great extent irrelevant, for in balancing the budget the Imperial Palace depends almost as much on the landlords and the church as they in turn depend on the Imperial Palace during the year.

The greatest need would appear to be modernization of the tax system. The collection of taxes on a monthly basis creates waste and inefficiency and reinforces bureaucratic tendencies. The flexible power wielded by the Minister of Finance in many of the programs defeats institutionalization and permits a high degree of personalization. Uncertainty as to whether money will be reallocated to the provinces in the case of the health and education taxes breeds distrust in the taxpayers causing many to avoid payment. The lack of permanent institutions encourages efforts to beat the system. If the wealthy and landed can escape much of their payment and are seldom prosecuted for so doing, the poorer populace will attempt the same strategy. Because the enforcement process is so inadequate, tax evasion is engendered throughout all levels of society. Failings in the system also exist in the simplistic nature of many of the laws. For instance, "there is no income tax allowance for married couples with children. A man who is married is subjected to the same rate of income tax as a single man if the two fall in the same income class. . . ."<sup>35</sup>

If the Ethiopian tax system remains unchanged, revenue from taxes, though continuing to increase, will actually decrease proportionally, until the political system will be forced either into bankruptcy or to reform the tax policy. The Emperor's recommendation to streamline the tax structure, though commendable, is not the final answer. Alongside this new proclamation should come proposals for more highly trained tax ad-

<sup>34</sup> *Ethiopia-Statistical Abstract, op. cit.*, p. 141.

<sup>35</sup> Ministry of Commerce and Industry, Ethiopia, *Ethiopia Economic Review*, Addis Ababa, No. 5, p. 49.

ministrators, assessors, and auditors, more advanced methods of record keeping, a modern system of measuring income and production, and a more independent judiciary which will be able to adjudicate disputes and enforce its decisions. And these changes must be more than additions to the statutes; they must be put into practice.

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### *Change in Fuel Relationships*

DIFFERENT FUELS COMPETE among themselves for the same market. At present, the U. S. consumes energy at the rate of 61 quadrillion BTU per year. Expressed in other terms, this quantity of energy is equivalent to that of 6 gallons of oil each day for each man, woman and child in the U. S. By 1975 we expect that this energy consumption will have increased by about a third to nearly 82 billion quadrillion BTU. Taking into account the estimated increase in consumption due to a larger population, the per capita increase will be about 24 per cent. This indicates, of course, that we can continue to expect our standard of living to increase.

Electric power generation has grown by nearly 7 per cent per year over the last decade and it may well do this during the next one as well. Electricity has made its major inroads primarily into the household and small consumer sector of the economy and secondarily into the industrial sector. We expect this trend to continue. By 1975 possibly as much as 43 percent of the energy needs of households and small consumers will be provided by electricity.

There are many reasons to believe that electricity will become an increasingly formidable competitor for the home heating market. The principal reason centers around the possibility of continually lower prices for electricity. There have been major improvements in the efficiency of conventional power plants using oil, coal, or natural gas. These improvements have come about as a result of the ever-increasing sizes of turbo-generators for converting steam to electricity. Additionally, the Extra High Voltage transmission system has made possible the low cost interchange of electricity among utilities such that a new high capacity, low unit cost, efficient generator in one part of the country can serve demands in other areas. [From an address.]

A. A. DRAEGER

*Humble Oil & Refining Co.*

# The Impact on Japan of William Godwin's Ideas

By ATSUSHI SHIRAI

## I

### The Englishman

FROM 1783 TO 1834 William Godwin published a succession of ingeniously varied works that were widely and vehemently discussed and criticized. Many of them formed the basis for controversy in a number of fields. In the field of history, for example, there was his sociological *The Life of Chaucer* (1803) and his pro-Puritan *History of the Commonwealth* (1824-28) in four volumes. His *An Enquiry concerning Political Justice, and its Influence on general Virtue and Happiness* (1793) was a landmark in political theory. His *The Enquirer* (1797) agitated educational circles. To the field of the modern novel he contributed the socially critical *The Adventures of Caleb Williams* (1794) and the satanic *Mandeville* (1817). In the area of political action he wrote *Cursory Strictures* (1794) and *Considerations (of parliamentary) Bills* (1795). To the discipline of economics he added his *Of Population* (1820).

During the French Revolutionary and Napoleonic periods, with the complete defeat of those Englishmen who were spokesmen for reform, Godwin fell out of "extreme notoriety," as William Hazlitt put it in his *The Spirit of the Age* (1825). But he regained some measure of unsavory fame through the elopement of his daughter Mary—later the author of the Godwinian *Frankenstein*—to the poet Percy Bysshe Shelley, who happened to be married already. His publication, through his own firm, of a succession of highly original books for children, written by himself, Charles and Mary Lamb and others of his active literary circle, led to a flurry when the government set up a minor inquiry into the possibility that he was corrupting the minds of the young, as he was thought to have done a generation earlier. However, he was cleared of the charge.

Godwin's life and works have given rise to over 3,000 pieces of criticism and significant discussion, according to a new bibliography.<sup>1</sup>

As a Japanese I find it particularly interesting to survey the extent of Japan's awareness of Godwin's important contributions in the various fields indicated. During much of the time that the Western world was arguing the merits of his strikingly individualistic—even anarchistic—ideas, Japan was almost entirely isolated intellectually. What has been the impact upon Japanese thinking of a writer so varied and so original

<sup>1</sup> B. R. Pollin, *Godwin Criticism: A Synoptic Bibliography* (Toronto, 1967).

as this man? In what direction, if any, does this impact lie? Who has written about it most extensively?

Godwin's ideas first reached Japanese minds with the growth of the study of political economy. Japan had to develop her economy rapidly after being opened to outside trade in 1854. It was not only Adam Smith with whom students of economics became acquainted. Thomas Robert Malthus's *An Essay on the Principle of Population*, in the abridgment by G. R. Drysdale, was translated in 1877 by Sadamasu Oshima. Godwin, of course, was a major source for this work of Malthus, as the full title on the first edition (London, 1798) shows: *An Essay on the Principle of Population, as it affects the future improvement of society with remarks on the speculations of Mr. Godwin, M. Condorcet, and other writers.*

The preface ascribed its origin to a conversation about Godwin's *Enquirer* and Malthus devoted many pages to arguing against specific tenets advanced in that work and in *Political Justice*.<sup>2</sup> This emphasis on Godwin's influence was reduced in later editions, so that many modern students do not know of Godwin's considerable role in provoking Malthus to discuss the population question. But historically minded scholars have always been aware of this fact.

In Japan the second translation of Malthus's *Essay* was of Ashley's abridgment. It was done by Masatake Mikami in 1910. In 1923 and in 1924 translations of the full first edition were produced, the earlier by Yoshihiko Taniguchi, the later by Takano and Ouchi. The great interest in Malthus and, by association, in Godwin, was indicated by the succession of translations that followed—for example, Ashley's version in 1924, this time by Masataka Suzuki; Malthus's seventh edition by Hara Sakuma in 1925; the complete version of the sixth edition by Bunzo Kaminaga in 1927; and by Ito and Terao in 1929. A detailed comparison of Malthus and Godwin had been made in England by James Bonar in *Malthus and His Work*.<sup>3</sup> Translated by Hori and Yoshida in 1930, this greatly influenced the course of subsequent Godwin criticism in Japan.

Meanwhile, Godwin commentary had developed independently in Japan. Dr. Tokuzo Fukuda (1874–1930), who had studied under Lujo Brentano in Germany and who had absorbed the tradition of the new historical school, wrote on Godwin in 1913 in the *Keizai Dai-jisho* (Great

<sup>2</sup> Thomas Malthus, *Essay . . .* (London, 1798), pp. 81, 173–302.

<sup>3</sup> James Bonar, *Malthus and His Work* (London, 1885, and subsequent reprints). For a few of the passages on Godwin see pp. 9–13, 15, 27–28, 45, and 360–77.

Dictionary of Economics). He noted Godwin's influence on Charles Hall, William Thompson and Robert Owen and listed the three degrees of property defined by Godwin in *Political Justice*.<sup>4</sup> Dr. Fukuda's article was reprinted in *Keizaigaku Kosho* (A Reflection on Economics).<sup>5</sup> In 1916 Fukuda also published a lecture on this subject, entitled "Malthus Jinkoron Shuppan Toji no Hantai-ronsha tokuni Seisonken-ronsha" ("Antagonists in the Period of Malthus's Population Theory, Especially in Regard to the Right of Existence."). It appeared in a special number of *Keizai Ronso* of Kyoto University, issued in commemoration of the 150th anniversary of Malthus's birth. Here Fukuda again reprinted Godwin's passage on the three degrees of property and commented on Godwin's vigorous assertion of the right of existence as being basic to the concept of property, a statement far more extreme than that of Morelly. Fukuda honored Godwin as the founder of the school which asserts the individual's right to the whole product of his labor. In this Fukuda was following Anton Menger in *The Right to the Whole Produce of Labour* (*Das Recht auf den vollen Arbeitsertrag*, (Stuttgart, 1891). In the English translation of this work, by N. E. Tanner, the importance of Godwin among the early English radical socialist thinkers was affirmed in the introduction by H. S. Foxwell.<sup>6</sup> In acknowledging Godwin as the school's founder Dr. Fukuda did not go quite so far as did Menger and Foxwell. But since Fukuda was interested in establishing the validity of the right to existence rather than the authoritarian power of the ruler as the foundation of social policy, he did give Godwin an important role.

Next to Dr. Fukuda, Dr. Hajime Kawakami (1879-1946), the famous Marxian economist, deserves recognition for his handling of Godwin's influence. Kawakami had studied Western economic theories intensively before publishing his *Shihon-shugi Keizai-gaku no Shiteki Hatten* (The Historical Development of Capitalistic Economics) in 1923. In that work he summarized English economic thought from John Locke to John Ruskin. In the chapter on Malthus, Dr. Kawakami introduced the views of Godwin in *The Enquirer* and *Political Justice*. He also sketched the life of Godwin. His work consisted solely of objective summary and description, with no comment of his own.

<sup>4</sup> For a comprehensive and lucid explanation of this aspect of Godwin's thinking see Section IV, "Economic Thought," in F. E. L. Priestley's critical Introduction to *Political Justice* (Toronto, 1946), Vol. III, pp. 62-78, the first two volumes comprising a facsimile reprint of the third edition of Godwin's work.

<sup>5</sup> Loc. cit., (Tokyo, 1918), pp. 165-66.

<sup>6</sup> Anton Menger, *Right to the Whole Produce of Labour* (London, 1899), pp. xxvii-xxxi, 4-46, 68, 101, and 191.

A more extended interest in Godwin was shown by Kyoson Tsuchida (1891–1935), who proposed a type of thought called Culturism under the influence of the philosophical movement that might be termed neo-Kantianism. He wrote several long essays, entitled "Study of Godwin," for his private magazine, *Bunka Culture* (Vol. III, Nos. 4–5) in 1922. He developed four basic themes: 1) Godwin's view of an ideal society; 2) Godwin, Marx and Culturism—their interrelationship; 3) Godwin's criticism of contemporary society; 4) Godwin's methodology for social reform. In these essays Dr. Tsuchida held that the ideal society proposed by Marx in his *Critique of the Gotha Programme* (1875) is a form of anarchism and that Marx denied all resort to force and rejected even compulsion in asserting the right to demand the whole produce of labor. Marx, he went on, made labor an end in itself. The closeness of this view to Godwin's raised Godwin in Tsuchida's estimation and caused him to praise Godwin's ideal society. Tsuchida came to the conclusion that one could not ignore Godwin and that, indeed, many signs then pointed to his achieving proper recognition.

Among Japanese theorists on population, discussions of Malthus have always included Godwin's contribution, although the attitudes of these scholars have varied. For example, Shigeru Tamanoi included a survey, "William Godwin no Shiso" (William Godwin's Thought) in his *Jinko Shisoshi Ron* (On the History of Theories of Population) (1926). At about the same time Dr. Ryozauro Minami accepted almost completely Godwin's last work on the question, *Of Population* (1820), in which he systematically and in detail answered Malthus's theories which, by then, had won very wide adherence. Dr. Minami, in fact, almost attempted a translation of the book in his *Jinko-hosoku to Seison-ken-ron* (Law of Population and Theory of the Right to Existence) (1928). He declared:

All socialists are the followers of Godwin, in that they attribute poverty to the social system and make the question of eliminating poverty and securing the foundations of human life the duty of society as a whole.

A different emphasis was given by Hisaaki Ito in *Byodo Shakai no Hihyo—Godwin sonota* (Criticism of Equal Society—Godwin, etc.) in his *Malthus Jinko-ron no Kenkyu* (Study of Malthus's Population Theory) (1928). Ito also described the Godwin-Malthus controversy in detail and regarded Malthus's "victory" to be that of pessimism and of empiricism.

The next few years produced several new studies. Shinzo Koizumi published "Hoyaku Malthus Jinko-ron Kaidai" ("Introduction to the Japanese Translation of Malthus's Principle of Population") in *Mita*

*Gakkai Zasshi* (Mita Journal of Economics, Vol. 23, No. 9, 1929). Hideo Yoshida published "*Jinko-ron o meguru Ronso—Byodo-shugi o Chushin toshite*" ("Controversy on Population—Especially on Equality") in *Okura Gakkaishi* (New Series, Vol. 1, 1933). Shigeki Masuda pursued the discussion through "*Jinko Riron no Tairitsu ni okeru Kihon Mondai*" ("The Fundamental Problem in the Opposition Concerning the Population Theory") in *Jinko Mondai* (Population Problems, Vol. 1, No. 2, 1935). The last item in this exchange is Hisaaki Ito's "*Malthus tai Godwin no Jinko Ronso*" (The Controversy over Population between Malthus and Godwin) in *Shogaku Tokyu* (Economic Review of the Otaru University Institute of Economic Research, No. 9, 1934).

## II

## Godwin Studies in Japan

TRANSLATIONS OF GODWIN'S WORKS have also stimulated Japanese interest in his thinking, usually along the lines of economic and political theory. In 1923 Chuich Iwashiro translated the section of *Political Justice* called "Of Property," using the forthright first edition rather than the third.<sup>7</sup> Goro Matsumoto put into Japanese Salt's edition of the same text, in 1929.<sup>8</sup> The much fuller abridgment of the whole of *Political Justice*, published by Raymond A. Preston in two volumes (New York, 1926), was translated in 1930 by Kazuo Kato. During the second World War and the years directly before it, there was a lull in Godwin studies, for obvious reasons. After the war, studies in Europe and America became much more frequent, stimulated partly by F. E. L. Priestley's classic work of 1946 and by George Woodcock's *William Godwin*, published in the same year. In Japan there was recognition of this renewed interest through papers that were intended to introduce the commentaries of such scholars as David Fleisher, in *William Godwin, a Study in Liberalism* (New York, 1951), D. H. Monro, in *Godwin's Moral Philosophy* (London, 1953), A. E. Rodway, in *Godwin and the Age of Transition* (London, 1952), R. G. Grylls, in *William Godwin and His World* (London, 1953), and, more recently, B. R. Pollin, in *Education and Enlightenment in the Works of William Godwin* (New York, 1962). Some of these papers in Japan have gone much beyond the realm of sim-

<sup>7</sup> In the 1798 edition of *Political Justice* this section is found in Vol. II, pp. 420-554. The original form can be reconstructed through the collations offered by F. E. L. Priestley in the work's third volume, entitled "Introduction."

<sup>8</sup> Henry Salt, reprint of Book VIII of *Political Justice* (London, 1890, 1918, 1929, and 1949).

ple reviews and in themselves make independent contributions to the field of Godwin study. Their authors include Tamae Mizuta and Ryo Suzuki.<sup>9</sup>

The most complete study of Godwin, published in Japan and in Japanese, is my own, *William Godwin Kenkyu* (A Study of William Godwin).<sup>10</sup> Because of the language barrier, I hope that I may be permitted to state the sections of this work, especially since I have attempted to explain phases of Godwin's thought with emphases a bit different from those of previous commentators, all of whom I have taken into account. The book aims: 1) to introduce to the Japanese Godwin's life and works set in their background, dwelling on the epochal modernity of his educational viewpoint in *The Enquirer*; 2) to show the systematic development of his thought and its importance to English social and economic history; and 3) to estimate the significance of his thinking and the scope of his insight into the world's present and future social problems.

Since Godwin's educational viewpoint has been covered in many ways by previous studies in English, I shall discuss the area of his contributions to social and economic thought. Three prototypes of radicalism were found in the Puritan Revolution: the Independents, who wished to realize a bourgeois order through freedom and democracy; the Levellers, who wished for popular sovereignty and equality; and the Diggers, who aimed at a communistic society through such measures as the abolition of wage labor, private property and long parliaments, and by setting up a system of consumption based on providing for the necessities of life. The three types of radical groups reflected three economic interests: capitalists, independent producers, and workers. Such thinkers as John Locke, David Hume, Adam Smith, and Jeremy Bentham and the Philosophic Radicals

<sup>9</sup> Tamae Mizuta, "Henkaku-shiso to shiten no Museifu-shugi—Godwin 'Seiji teki Seigi' ni okeru Ningen-henkaku no Mondai" ("Anarchism as the Basis for Change—the Problem of Changing Humanity in *Political Justice*"), *Nagoya Daigaku Hosei Ronshu*, No. 13 (December, 1959); Ryo Suzuki, "Godwin ni okeru 'Seiji teki Seigi' no Kozo" ("The Structure of *Political Justice*"), *Shogaku Tokyu*, (*The Economic Review of Otaru University*), Vol. XI, Nos. 2–4 (1960–61); Ryo Suzuki, "William Godwin no Igirisu-kakumei Kan" ("William Godwin's View of the English Revolution"), *Shogaku Tokyu*, Vol. 12, No. 3 (1961); Atsushi Shirai, "Robert Owen to William Godwin" ("Robert Owen and William Godwin"), *Mita Gakkai Zasshi* (*Mita Journal of Economics*), Vol. 58, Nos. 1–2 (1965); Shirai, "Saikin no Godwin Kenkyu Bunken—Tokuni Godwin's Letters of Verax" by B. R. Pollin ni tsuite" ("Recent Studies on Godwin—especially on his 'Letters of Verax' by B. R. Pollin"), *ibid.*, Vol. 58, No. 10 (October, 1965) and Shirai, "On William Godwin" (in English), *Keio Economic Studies*, Vol. 3 (1965).

<sup>10</sup> Atsushi Shirai, *William Godwin Kenkyu* (Tokyo, 1964). In addition to the text, of 342 pages, the book includes several bibliographies of Godwin, his wife Mary Wollstonecraft, and his son-in-law, Percy Bysshe Shelley; Godwin's family tree; a chronological table of England and France during the period, and an extensive index.

stemmed from the first; and Joseph Priestley, Richard Price and Thomas Paine from the second.

Godwin rated the Independents very highly in his *History of the Commonwealth* and failed to evaluate the Diggers adequately because of the paucity of historical materials about them in his day. His inclinations are toward direct democracy, individualism, and other principles of the Levellers. But he went further than they did in regard to the abolition of the wage labor system and in his opposition to feudalism and to religion, etc. Godwin insisted on labor as the source of wealth, on the rule of reason, and on the viewpoint that social misery has purely external causes. In some ways he was a successor of the Diggers, although not in regard to political methodology. The book shows the impact of the French Revolution upon the thinking of Godwin and his friends, the divisions created within the groups in his day devoted to reform and the formation of the essentially transitional nature of "the spirit of the age." Reflecting this, Godwin appears not to have contributed any original theory of political economy, although his basic optimism or belief in perfectibility can be said to have given his ideas a consistent orientation. His system approached the formalism of anarchistic communism through the prevalent stress on the rational self and the thoroughgoing democracy of its suggested institutional forms, intended to be utterly flexible and responsive to the wills of the entire electorate.

To deal with the third phase—his current and future significance—one has to take into account the meaning of his anarchistic communism, so hostile to the idea of violence.

Much has been said of late about "alienation," a concept critical of traditional economics which concerns the acquisition of wealth and the legal preservation of private property. Marx took up characteristics of the "alienation" theory in formulating his historical materialism. But antecedent to Marx were the moral and religious spokesmen for sharing of property, starting in a sense with Sir Thomas More and culminating in Godwin.

On the one hand they attacked the validity of wealth-getting, represented best (but, of course, at a later time) by the classical economists, and on the other hand they regarded as paramount the sacredness of individual freedom. Thus they were in accord with the anti-absolutism of liberal, bourgeois political theorists of the 18th century. The sacredness of individual development and expression becomes a feature of the criticism of the division of labor, which Godwin particularly considered to

be a product of human avarice, leading to monopoly, the indolence of proprietors, and the exploitation of workers. Therefore, Godwin would eliminate it, along with private property, from the rationalized world.

Machinery would help to abolish all labor, save for a necessary modicum of two hours a day given by each individual. The activities to supplant useless labor in the ideal State would become intellectual or creative pursuits, genuinely expressive of the individual's personality when freed from ostentation and extrinsic motives. This vision is now amply vindicated by the remarkable progress of scientific techniques and also by the essential nullification of the Malthusian theory through family planning and increased food production.

Godwin's utopian thought, it is shown, is a philosophical treasury of new materials for further studies and for intellectual development.

A proviso must be made concerning present and future studies in Japan of Godwin. Despite the provocative nature of his ideas, it cannot be said that the anarchist movements as such, in Japan, have been much influenced by Godwin—but rather by Peter Kropotkin and Michail Bakunin. Few if any references to Godwin's effect upon romantic literature can be found in Japan, although this would, naturally, be a somewhat transplanted interest.

However, with the development of a keen interest in Western literary movements and the developments of movements in art paralleling those of the Western world, Godwin's contributions to the novel and also his excellent analysis of reading and of style in *The Enquirer* will assume a greater interest in Japan as well. There is no doubt that he will gain increasing recognition from Japanese students in every discipline as a force worth considering and worth reading for his own sake.

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### *Grid for Exchanging Information*

USE OF ELECTRONIC data-processing techniques may lead to creation of a world information grid, according to Leonard H. Marks, Director of the U.S. Information Agency. Such a grid would eventually make possible the easy retrieval and transfer to any point on earth of any item of the total sum of man's million-year written accumulation of knowledge. Marks also predicts that by the year 1980—a mere decade from now—the amount of additional information collected by man will be greater than all the past 2,000 years. [From the U.S. Department of State.]

## REVIEWS

### Appraisal of the Property Tax<sup>1</sup>

By GEORGE G. SAUSE

THE LITERATURE concerning the property tax is voluminous and has been accumulating for over a century. As everyone who has delved even casually into these writings knows, the critical judgment of the vast majority of writers has been hostile. Jens Peter Jensen, in his classic work of 1931,<sup>2</sup> comments on the property tax, "One searches in vain for one of its friends to defend it intelligently. . . . No writer of repute writing on state and local taxation in the United States has failed to offer his bit of derogatory testimony. . . . Yet the tax persists." Netzer may or may not be a friend of the property tax; he does defend it intelligently while noting its defects.

The thoroughgoing nature of this study plus the reputation of its author suggest comparison with Jensen's classic volume. This thought obviously occurred to Netzer who states in the preface that the book is not a latter day version of Jensen. Two main differences in the topics covered are noted by Netzer. First, the latter volume considers only briefly the application of an ad valorem tax to specialized types of properties, such as timber land, mining, railroads, public utilities, and financial institutions. One suspects this brevity is recognition that the subjects are adequately discussed in many other places. Also, it reflects the decreasing interest in these topics as some of these industries decline relative to the rest of the economy.

The second major difference noted by Netzer is the limited treatment of property tax administration in his work. It is true there is no attempt to discuss the administration of the tax in detail. In particular, Netzer spares the reader the oft-repeated description of administrative defects; nevertheless, the comments he makes on standards of administrative excellence and reasons for present conditions are valuable.

Other comparisons of Jensen's and Netzer's works indicate both change

<sup>1</sup> *Economics of the Property Tax*. By Dick Netzer. Washington: The Brookings Institution, 1966 (reprinted, February 1967), 337 pp., \$2.50.

<sup>2</sup> Jens Peter Jensen, *Property Taxation in the United States* (Chicago: University of Chicago Press, 1931), p. 478.

and stability in the attitudes of specialists in public finance. Both men consider the fiscal adequacy of the tax as well as its impact and incidence and thus the distribution of the burden. Netzer, however, seems less concerned with uniformity problems and exemptions. In contrast to Jensen, he places more importance on locational effects and other questions of neutrality. Finally, the effect of the tax on new problems, such as the urban crisis, are considered at some length.

As is true of many books in this area, *Economics of the Property Tax* contains a wealth of statistical data. The author has drawn heavily on data supplied by U.S. Government sources and other writers. Nevertheless, he is forced to make many quantitative estimates—details of which are explained in appendices. This reviewer was impressed by the fact that considerable vital information is unavailable despite the best efforts of the Census Bureau and related agencies.

#### The Work's Contents

CHAPTER I SUMMARIZES the history of the property tax in the United States and compares it with similar institutions in other countries. It is particularly interesting to note that despite a century of criticism and reports of erosion of the base and of relative decline property taxes in 1963 were equal to approximately 3.4 per cent of Gross National Product, the same figure as the estimate for 1870. Changes have occurred of course. In the interval the tax has become less general in coverage and the states have largely relinquished it to the local units.

Criticism of the institution, although never absent, has varied in intensity and type. It reached peaks in the late 19th century and the 1930s and has subsided to what is described as a "new complacency" in the last decade.

In the second chapter, Netzer studies the impact of the property tax; that is, he attempts to identify the individuals and businesses who make the tax payments and to estimate the relative shares paid by the several groups. Despite the importance of the tax, this sort of information is not readily available. In fact, prior to 1957 data of a nature permitting such estimates did not exist. For that year, the author by using Bureau of the Census reports is able to present statistics showing payments made by the several types of property owners and the different industrial categories. An analysis of these data shows that the popular impression of the tax as nonneutral is correct. For example, property taxes amount to 11.6 per cent of the National Income originating in the electric and gas utility industries, and only 0.04 per cent in the air transportation section.

Pipelines, telephone and telegraph, and railroads range from 7.0 per cent to 4.9 per cent. Manufacturing shows an average payment of 0.98 per cent of value added; however, the range extends from 2.56 per cent for petroleum and coal to a low of 0.32 per cent for apparel and related products.

The author also notes that the property tax on housing is extremely high if compared with excise taxes on other consumer items. It ranges from 17 to 27 per cent of housing costs for the several categories. As noted later, this discrimination against housing is balanced by the deductibility features of the Federal tax system and by the services financed by the property tax.

After examining the impact of property taxes, Netzer tackles the more difficult question, who pays the property tax? In Chapter III the reader is guided through shifting and incidence theory. Evaluation by comparison with empirical evidence is used wherever appropriate data are available. Although most of the conclusions reached are not surprising, valuable insights are provided.

With respect to bare land, or the site value of real estate, economists have long concluded the property tax is borne by the owner at the time the tax is initially imposed. This conclusion follows a chain of reasoning which begins with the knowledge that the supply of land is fixed. Capitalization theory reaches the same result for taxes on bare land. Netzer supports these conclusions; nevertheless, he notes the need for more empirical evidence and cites the arguments of critics.

Determination of the incidence of the tax on improvements is more difficult. In the simple approach, one concludes that in the long run the tax is shifted forward because it discourages investment and thus reduces supply. Economists criticize this analysis because it is based on partial rather than general equilibrium. Specifically, it ignores the effect of the tax on saving. If it is assumed real saving is not affected by the tax, there can be no effect on aggregate investment. In which case, the tax on improvements cannot be shifted. Netzer notes other obstacles to shifting such as single family houses held for purposes other than investment income, the lengthy but imprecisely measured time span defined by the term "the long run," and the unequal burden of the tax between different areas. After reading this section and noting the references to other studies, this reviewer concluded that the question who pays the property tax on improvements cannot be answered on the basis of present information.

Readers with little or great interest in economic analysis will find the

section on incidence by income class valuable. Netzer's findings support the conventional wisdom that property taxes are somewhat regressive with respect to income. This is true for the portion of the tax collected from residential as well as nonresidential property. In the latter case the conclusion rests on the assumption the tax is shifted forward and consequently becomes a consumption tax. This simple approach becomes complicated when two additional factors are considered: the deductibility feature in the Federal income tax tends to increase the regressivity of property as well as all other state and local rates. Conversely, the author notes that the services financed by property taxes are regressive. Regressive in this instance means the ratio of benefit to income declines as income rises. So powerful is this latter factor that Netzer concludes the property tax plays a significant, albeit uneven role in income redistribution from the rich to the poor.

In Chapter IV Netzer considers the economic effects of the tax; that is, the classical question of neutrality. It is assumed that the existence of the property tax influences the choices a rational person makes with respect to expenditure. The effects on decisions are considered (1) if another tax were used in place of the levy on property, and (2) if the property tax and the expenditures thus financed were both eliminated. Conventional economic analysis and empirical evidence are used with the latter method suffering from insufficient data.

#### Property vs. Income Taxation

WHEN COMPARED with another source of revenue, *e. g.*, the income tax, the levy on property obviously discriminates against housing and business structures and equipment, the forms of wealth usually subject to the levy. This may be socially desirable if one also considers the benefits thus financed. Netzer cites estimates indicating about 50 per cent of property tax receipts finances education and another 20 per cent supports health, welfare, and other human services. Since many economists believe investment in the human factor yields a higher return than physical capital, the result is a reallocation of resources in a socially desirable direction. The remaining 30 per cent of the revenue, incidentally, goes to fire protection, street maintenance, and other services to property.

All the effects are not beneficial however. In some cases differences in tax rates between areas leads to locational decisions that are not in the direction of the optimal allocation of resources. Netzer notes that tax differentials need not always have this allocative effect. If the difference in tax burden is balanced by a difference in expenditures yielding benefits

to the property, the effect is neutral. Of course, not all tax differentials between areas are in this category.

In this and the following chapter, Netzer considers the urban problem. His evidence indicates the property tax probably works as a disincentive to investment in the older portions of large cities. He also supports the widely held belief that cities use nonuniform assessments as a means of taxing business and multifamily residences more heavily than single family homes. Finally, he notes that the tax works against urban renewal by discouraging the replacement of old single family residences with new apartments. Although the author has restricted this portion of his study to large cities, the results seem to describe small and medium cities as well.

Geographic differentials are discussed in Chapter V. The key issue is the economic effect of property tax differentials on the location of economic activity, a point which bears directly on the urban problem.

Netzer divides the problem into interarea and intra-area differences. For interarea studies, the state is the logical unit and sizable differences between states are shown to exist if the property tax is measured either as a per cent of state and local tax revenue or as collections for \$1,000 of personal income. Although property taxes tend to be more important in the richer urbanized states, there are many exceptions. Differentials between areas may reflect a preference for public as opposed to private goods or the choice of other forms of taxation. The differentials have some effect on location of industry and other economic activity, but generalizations are difficult and must be qualified by noting exceptions. For some types of activity, choice of location is fixed, ability to move to low tax areas varies for different industries, and tax incentives may be of minor importance compared to other factors. In some instances a tax differential reflects a real economy in the need for services, hence the decision to locate is socially desirable. Most tax differences, however, do not reflect a real saving with respect to the need for public services but rather an ability to transfer the burden to other units of government. Although location is influenced, usually in an undesirable direction from the point of view of the whole economy, Netzer concludes the effect is not disastrous since many other factors are present.

Intra-area differentials, specifically within urban areas, contribute to the current social problem. There is a tendency for the poor and disadvantaged to cluster in or near the downtown district concentrating the need for welfare services in the central political unit. In addition, because of size, central city units have supported services, such as water

systems and museums, with increasing returns to scale. Hence, central city taxpayers have been supporting services available to the entire area. It is claimed that this problem did not reach a crisis stage earlier because of a tendency for business activity, and thus a rich tax base, to be concentrated within the city. In recent years the decentralization trend in industry and commerce has eroded the tax base. Property tax differentials did not create the urban problem but they do work in the direction of further decentralization and become part of a vicious circle: industry moves to the suburbs and reduces the central city's property tax base. Since the need for services does not decline, city tax rates are raised and the incentive to decentralize becomes stronger.

In some instances the trend is encouraged by zoning and other devices in suburban areas which discourage settlement by low income persons and other service absorbing types. The resultant low tax rates attract industry which expands the tax base. This leads to still lower rates thus increasing the differential and exacerbating the urban problem.

There are several proposals for reform but none seems to have much chance of immediate acceptance. The problem arises because of a pattern of fragmented local government which does not balance service responsibilities with tax resources. A basic solution involves an enlargement of the local government areas. The ideal government unit should have boundaries including an optimum service area and an optimum tax area. Defining these boundaries short of the nation's borders would be difficult. Modification of this plan based on the same basic principle includes proposals for county and state grants.

Netzer concludes, ". . . if intrametropolitan variations in property tax rates are not simply a product of consumer choice and if they result in adverse consequences which are considered serious—both of which conditions seem to obtain in many places—then it is not hard to devise means of reducing the dimensions of the problem."<sup>3</sup> Unfortunately, it is easier to devise solutions to the problem than to get these solutions accepted by the public and implemented by the political units.

#### Personal Property Taxation

THE PERSONAL PROPERTY COMPONENT of the tax base is the subject of Chapter VI. Earlier writers waxed indignant when describing the conceptual and administrative defects of this institution. Netzer, using statistical data which only recently became available, is typical of the new school and presents an objective analysis.

<sup>3</sup> *Loc. cit.*, p. 137.

All intangible personal property is included in the legal tax base of only nine states (plus Alaska by local option). An additional five states levy general property tax rates upon certain classes of intangibles but in only one state, West Virginia, is the intangible component a significant portion of the tax base. This indicates states have recognized that such property is highly mobile and easily concealed. Also the incentive to evade or avoid the assessment is greater than for real property because the fixed value nature of the assets precludes underassessment.

All tangible personal property is exempt from taxation in only four states; partial exemption is widespread so that only sixteen states have substantial general coverage. Selections for exemptions appear to be influenced by the difficulty of assessment as well as the number of voters concerned with the different categories. Netzer uses Goldsmith's<sup>4</sup> data in estimating that 21 per cent of tangible personal property is legally subject to taxation. Because of legal and extralegal exemptions the burden is borne most heavily by commercial and industrial assets. As a result the share of the property tax paid by business increases relative to the results if only real property were taxed.

The author analyzes the economic consequences of the tax on personalty by noting the locational effects and the degree of regressivity as compared to alternative revenue sources. He concludes: (1) it is less regressive than the real property tax but has greater locational effect; (2) it is more regressive than a corporate income tax but has a smaller effect on location; (3) it is less regressive than a sales tax if the latter has few exemptions; however, it has a greater locational effect if one accepts the assumption that sales taxes are shifted to the consumer; and (4) by definition it is more regressive than a personal income tax while locational effects cannot be compared.

After reading this chapter, it seems clear the traditional criticism that it is impossible to administer the personal property tax in an equitable and efficient manner is valid. The tax produces some undesirable economic effects and the revenue it raises could be gained from other sources.

In Chapter VII the author presents a general appraisal of the property tax. He finds a number of positive as well as negative features.

The tax achieves vertical equity; that is, it redistributes income from the rich to the poor. This result occurs because the tax is "... more or less proportional in its incidence among income groups, but the expendi-

<sup>4</sup> Raymond W. Goldsmith, *The National Wealth of the United States in the Postwar Period* (Princeton, N.J.: Princeton University Press for the National Bureau of Economic Research, 1962).

tures it finances are very heavily 'pro-poor.' . . ."<sup>5</sup> In addition the expenditures tend to increase the allocation of resources to human capital which yields a higher return than physical assets.

Some of the advantages claimed for the tax are challenged. For example, Netzer agrees that the tax is amenable to small incremental changes, but this is a consequence of the residual determination of rates and could occur with some other taxes. The author also challenges the special link between the property tax and the autonomy of local governments. This is a valid conclusion only if there are no intra-area rate differentials.

Some widely held criticisms of the tax are refuted. It does not seem to have a significant effect in encouraging an inefficient spatial distribution of economic activity nor is the deterrent effect on housing of great consequence. The latter point is explained by the balancing effect of schools which are financed by property taxes in the suburbs, the area where most housing has been built in recent years.

Other critical judgments are sustained. Although the tax redistributes income in a desired direction, the effect is uneven both within and between metropolitan areas. In addition it is regressive in effect between high and low governmental units. The tax violates the principle that equals should receive equal treatment. Inequality of assessments plus various individual consumption patterns regarding housing explain this defect. The tax is not neutral. It discourages the development of industries with high capital requirements; for example, railroads. Furthermore, it is a deterrent to the rebuilding of cities and encourages land use planning to maximize narrow parochial interests rather than broad social goals.

The author questions the principles justifying the tax on realty. The tax on housing may be viewed as a very high excise tax on housing expenditures. In that case should the base be all consumption expenditures or at least housing expenditures rather than capital value? The justification for the tax on business properties is criticized also. The benefit theory and its "social overhead" variation are rejected leaving little other than opportunism as an explanation for a tax on business. If business is taxed, would value added or gross receipts serve as a better base?

The administration of the tax or more precisely the assessment process is considered next. Its defects are many and have been well publicized. Despite a century of criticism these shortcomings persist, suggesting that

<sup>5</sup> *Loc. cit.*, pp. 164-5. The tax was shown to be "somewhat" regressive in Chapter III.

factors other than incompetence and obstinacy of assessors are the cause. Netzer indicates that it is a matter of choice. Better assessments are possible but only at a cost which may not be acceptable. On the whole administration does not receive a high grade. The author cites Bird's<sup>6</sup> "standard of excellence." Bird rates an assessment jurisdiction as satisfactory if assessment to sales studies for single family nonfarm houses show an average deviation of no more than 20 per cent of the median ratio. By this standard 21 per cent of the areas studied in 1957 and 30 per cent in 1960 receive passing grades. Thus approximately one third of the assessment jurisdictions do acceptable work; however, compared with other taxes the standard of excellence is low. The high coefficient of dispersion means the taxpayer in an "excellent" district is faced with a tax bill 20 per cent above or below the correct figure. This would not be condoned by income or sales tax administrators. Early critics who concluded the property tax is inadministrable seem to be sustained at least to a degree.

In Chapter VIII the author summarizes his position. Although the American property tax has not fared too well in his study, there is a rational case for local governments to continue to rely heavily on some form of real property taxation. The relative short-term immobility of investment in real property is one basis for this opinion.

#### Property Tax Reform

IF REALTY IS TO BE TAXED, is the present American system the best device? Five alternative forms of the local realty tax are considered. Taxation based on the annual value of real estate, the British system, is rejected. Compared with the American system it has adverse economic effects: the tax burden may be reduced by holding a property vacant. From an administrative standpoint, neither the annual nor the capital value system has an advantage.

Site value taxation is treated in some detail. The familiar criticism that site and improvement values cannot be separated is judged invalid. The author awards high grades to the tax with respect to resource allocation for reasons presented in this *Journal* on many occasions. Also, it is administratively feasible. On the negative side there are questions of revenue adequacy and of equity. Netzer estimates a tax on location value alone would not produce sufficient revenue to replace the current tax on realty. Consequently, some levy on improvements would be necessary

<sup>6</sup> Frederick L. Bird, *The General Property Tax: Findings of the 1957 Census of Governments* (Public Administration Service, 1960).

and the practical alternative is not pure site value taxation but some version of the graded tax, such as is found in Pittsburgh and Scranton. An equity problem arises, of course, whenever a tax is shifted to a different base.

A tax on increments in land value avoids the equity problem, especially if the tax is levied at the time of transfer. Furthermore, there is a particularly strong case for this levy if the increased value occurs because of public improvements, in which case a special assessment may be viewed as an application of the principle. The tax receives low marks on adequacy but this should not prevent its use wherever appropriate.

Fourth, a "family of user charges" is considered. If this application of the benefit principle is accepted, levies on realty would be reduced to the point where they finance only services beneficial to property: for example, fire protection, water supply, sewerage, and refuse disposal. Consequently, the system receives a low grade on adequacy. While this approach has some appeal on equity grounds, it must be noted that benefits are not measured accurately by capital or rental property values.

There is a fifth alternative, levy a tax on housing but not on the improvement component of industrial and commercial properties. If one ignores the political implications, this proposal can be justified. It has already been stated that, except for the benefit component, ad valorem taxes on business improvements can only be explained as opportunism. Also, taxes that are levied on business should be based on gross receipts or value added rather than property value. It is true the tax on residential properties, if considered by itself, discriminates against housing as opposed to other consumption choices, but there are other taxes such as those on sales and income which favor housing expenditures. Netzer therefore justifies a tax on housing since it balances the nonneutral effects of other levies. Logically, the base should be housing expenditures, not residential property values. As an alternative to the present system it would be, of course, inadequate as a revenue producer.

In summary we find that four of the five alternatives are preferable to the American property tax on grounds of equity and economic effect, but no one of them is able to replace the present system as a revenue producer. Would the four taken together be adequate? The author estimates they would if used as outlined below:

1. A site value tax equal to one half the rent of land.
2. A land value increment tax at 20 per cent.
3. User charge type property taxes whenever appropriate.
4. A housing tax at not more than 5 per cent of housing costs.

Thus, he concludes, a radical change is feasible. The political effort needed to achieve such a change would, of course, be sizable and there are other problems. Administration of the four taxes would be more difficult and expensive than the present system. Also a transition from one tax system to another inevitably creates inequitable effects: substantial windfall losses and gains occur as the tax burden is redistributed.

In the four years since the book was written some conditions have changed. The urban problem has become more acute and is more generally recognized. Netzer's analysis of the fiscal factors involved in this problem is an valid as ever.

Exempt property, particularly in the urban centers, has recently attracted attention. This book does not treat the problem specifically at great length but the reader may draw certain inferences. One is tempted to condemn exemptions because they violate the principle of neutrality. However, this criticism is not valid for all cases since motivation for these exemptions is based on a desire to influence economic decisions. Instead it is necessary to question the social desirability of each type of exemption and to ask if a better method of achieving this end is available. We may also note that the fiscal problem of the central city districts has not been caused by exemptions. The troubles are more fundamental and the solution is not a simple matter of eliminating or reducing the amount of property exempt from taxation.

Because of the increasing seriousness of the urban problem, attempts to increase revenue through the use of municipal sales and income taxes have grown. A comparison of these levies with the property tax, however, calls for a separate volume. Solution of the problem by this method seems unlikely and probably undesirable. Federal and state grants are better alternatives.

Inferences can also be drawn regarding the controversy over the division of resources between public and private goods. Given the municipalities' present responsibility for certain types of public goods, the choice is influenced by the limitations of the property tax. Federal and state units again appear to provide a solution.

The volume contains valuable policy implications even if one rejects the radical suggestion of the alternative forms of taxation previously noted. They are:

1. Promote intra-area rate and assessment uniformity. This implies changes in current municipal boundaries.
2. Improve the accuracy of assessments. Perfection in this area is not possible and a choice must be made between high-quality

- performance and cost of administration.
3. Resist proposals offering "tax relief" to homeowners. Preferential treatment by other taxes more than balances the realty tax discrimination against residential expenditures.
  4. Tax site values at higher rates than improvements. Pittsburgh and Scranton serve as examples.
  5. Tax increments to site values. Greater use of special assessments is a method which is currently used and could be expanded.
  6. Levy user charges where appropriate.
  7. Recognize that the preceding reforms will not solve all the problems. Federal and state assistance is needed.

Netzer's book presents an excellent analysis of the economic effects of the present system and should be read by anyone concerned with local government problems. It is to be hoped that his conclusions will be carefully considered.

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## New Interest in William Godwin

By WALTER A. SEDELOW JR.

AMONG THE MANY interesting, unusual, and useful characteristics of Burton R. Pollin's *Godwin Criticism, a Synoptic Bibliography*<sup>1</sup> is a decennial census of publications concerning Godwin (p. 654), which provides an empiric confirmation of one's hunch that in recent decades there has been a resurgence of interest in Godwin's work. Godwin's notion that, since men are rational creatures, they can live in harmony without laws and institutions must have some appeal in a time when the laws and institutions are under challenge. As theorist of an ideal society, as critic of modern society, and as social reformer, Godwin might be expected to arouse interest among those searching for answers in these directions. I would venture an extrapolation from Pollin's data and surmise that in successive student generations there will be a continuation of this growth of interest, of which one result will be a multiplication of published responses to the Godwinian stimulus.

Pollin's work of compiling the publications about Godwin's impact

<sup>1</sup> *Godwin Criticism, A Synoptic Bibliography*. By Burton R. Pollin. Toronto, Can.: University of Toronto Press, 1967.

and commenting upon them should facilitate further careful research not only on Godwin's writings, but also on the diffusion of the elements in the variegated Godwin images and, perhaps, on characteristics of such a diffusion process in the history of 'ideas.' Pollin himself discloses an intention "ultimately to ask other questions of the machine, using the disked material of this bibliography, for a study of Godwin's influence and popularity through the years and also outside England" (p. xxxvi).

The principal element (544 pages of 659 + xlv) in this book is the reproduction of a computer print-out of 3,379 annotated bibliographic entries concerning Godwin criticism and allusion<sup>2</sup> (author, title, and publication data in one block of each entry; and Pollin's summary annotation of the cited item's contents in a second block). Some further sense of the magnitude of Professor Pollin's effort can be gleaned from his report that "all but three hundred entries were personally annotated by me from my own notes; in about 150 instances, from the notes of correspondents" (p. xxii). The very considerable labors that must go into a project of this scale were made possible by two grants from the American Philosophical Society, one from the New York State University Research Foundation, and another from the Carl and Lily Pforzheimer Foundation; library trips to England and the Continent were among the scholarly actions facilitated by grant funds. One indication of the care with which this work was done is the apparent paucity of typographical error: entries 2,074 ("the villain's uses advanced technology") and 4,052 ("but not old G[odwin] with his ergotism") contain the only such errors I have noticed. Pollin's entries include items in fourteen languages; and he notes the collaborative assistance of students and scholars, some as far away as Budapest and Tokyo (47 Japanese entries).

This bibliographical tour de force was made possible not only by the sustained application of Pollin's learning, intelligence, and energies and by the assistance he received at home and abroad from scholars, librarians, and administrators, but also by the technical skills and facilities made available to him by specialists in computer technology. This work is of importance for Godwin scholars and cultural historians, and for sociologists of literature and communication, and it is also of significance as a good model among the increasing number of works of humanistic scholarship in which the computer has been implicated. There is, in addition to Pollin's own introductory commentary in which he mentions various aspects of the man-machine interaction which led to this book, a technical

<sup>2</sup> For Pollin's criteria as to a Godwin reference, see pp. xxii and xxiii of his introduction.

introduction of some eight pages in which Dr. George Logemann, who directed the computer programming, discusses the ideas, equipment, and procedures that governed the preparation of both the bibliographic entries and the eleven indices. These useful indices, discussed on pp. xxvi-xxxvii, are of Persons Mentioned; Books Mentioned; Authors of Books and Articles; Chronological Listing of all Articles; Reviews of Godwin's Works; Important Studies of Godwin; Reviews of Books on Godwin; Languages of the Original Sources; Names of the Periodicals Annotated; Statistical Lists; List of Godwin's Writings. Some features—in particular, some of the indices—would not have been readily produced without the computer's assistance, and others were constrained by the state-of-the-art at the time of its production; in one section of his introduction Pollin discusses "elements attributable to the computer." Improvements in what the computer can do are frequent, and today he would doubtless make use of upper and lower case, for example, if he were starting out on the production of such a work.

Earlier I mentioned the typographical accuracy of the bibliographical entries, and it is significant to note that one of Pollin's objectives was so to utilize the computer's capacities as "to avoid the many errors that conventional typesetting can introduce into the successive proofs of a printed book, especially one of a bibliographical nature" (p. xi). There is a signal tribute to Logemann's skills with machines and with people when Pollin writes of "the foresight of Dr. Logemann, who designed a general system of computer programs whereby I was allowed control over the items to be extracted and indexed and complete editing facility in preparing the final textual items and the many indices to them," for it is a chronic and serious complaint of many academicians using computers that they feel they have lost control over their own work in so doing. For example, in contrast with Pollin's experience, one might note both the editor's prefatory comment and discussion *passim* in James Beshers, *The Simulation of Large-Scale Social Systems*,<sup>3</sup> (M.I.T. Press, 1964). Pollin's encomium of Logemann adds a further weight to Logemann's observation that

with proper programming, the author never loses control over his data. Changes are made correctly and do not engender other errors. It will be possible to create, in the future, a system in which the logical implications of any change are automatically pursued by the computer in such a way that the output, the final printing, is completely free from errors [that have been *once* corrected] (p. xlv).

<sup>3</sup> *Op. cit.* (Cambridge, Mass.: M.I.T. Press, 1964).

For those whose interest in this book is principally for the technique of its preparation and production it may be helpful to mention, for technical context as to the scope of what is now possible in the way of work with language by machine, *Automated Language Analysis*, edited by Harold Borko.<sup>4</sup>

The general scheme for displaying the bibliographical data proper is succinctly stated by Pollin in remarks on Arrangement:

The plan . . . was to divide all the material into four sections, in terms of the date and the nature of the entry . . . the first time-span, covering his career as author, was 1783–1836. All critiques and allusions published after 1836 were placed in the second broad category. Within each of these divisions the material was then to be grouped into the categories, first, of periodicals, including magazines, daily and weekly newspapers, and annuals; second, of books and pamphlets (p. xii).

And he employed a set of identifying symbols to designate the type of publication and relationship to Godwin. The usage rules for these symbols are explicated by Pollin in his introduction and two of the categories—those with which the symbols GQ and G are associated, for Godwin Quoted and Godwin—receive a special justification. The argument is that the GQ passages contain an implicit praise of Godwin, and that although the G entries “might be said to stretch the limits of criticism and allusion a bit” they are a means of calling attention to journalistic writings of Godwin which “have not been listed in bibliographies as yet, and this is one means whereby I can call attention to these striking but only partially studied materials” (p. xxiv).

Reading the annotations can be an enjoyable experience in its own right, even though their purpose is rather purely instrumental. Frequently they provide evocative reminders of significant chapters in intellectual history, and on occasion they are even entertaining. When I was an undergraduate at one of the colleges of which he had been president, there was a calculatedly irreverent Zephaniah Swift Moore Beer Drinking Contest, and I discovered with interest that in 1802 he had pronounced at Worcester in Massachusetts an oration (item 1,653) in which he lamented the substitution of ignorance for depravity as the root of social evil and urged his auditors to “scorn the visionary theories of the Godwins of the present day.” There are a couple of engaging references to the life of the mind in Salem as the 19th century began, with a French visitor commenting (item 34) on a school there where “girls learn to ride, skate, and view men as tyrants” and a Boston publication urging (item

<sup>4</sup> *Op. cit.* (New York: Wiley, 1967).

294) the intellectual Salem ladies to shift their attention from Mary Wollstonecraft to Hannah More! There is at least one instance in which Pollin has rather explicitly 'editorialized' within an annotation (item 3,863); sometimes he has quietly added information relating later scholarship to an entry (items 1,527, 2,425).

Something of the total scope of Pollin's contribution to Godwin scholarship is revealed in the necessary references to other of his own publications, and *Godwin Criticism* also contains news of other Godwin efforts that Pollin has in mind.

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PROFESSOR HAROLD F. WILLIAMSON, secretary of the American Economic Association, informs us in a letter of May 22, 1969 that the failure to include the *American Journal of Economics & Sociology* among the journals notified of the policies suggested for the protection of author's reprint rights by the association's executive committee was an oversight. (Cf. "Protection of Author's Reprint Rights," *Am. J. Econ. Sociol.*, Vol. 28, No. 2, April 1969, p. 213ff.) Professor Williamson invited the editor of this journal to the annual luncheon meeting of editors of social science journals at the New York Hilton Hotel in New York, Dec. 28, 1969; the invitation was accepted with thanks.



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## Land Subdivision and Development:

### *American Attitudes on Land Subdivision and its Controls*

By RICHARD M. YEARWOOD

#### I

#### Introduction

SPECULATION IN LAND is as old as the United States itself, as Philip Cornick demonstrated in his landmark study.<sup>1</sup> In fact, land speculation has become a tradition in this country.

Speculation in land has been a tradition in America and was in fact a major motivating force in opening the West. . . . This speculative bent still colors American attitudes towards the land and is a factor to be reckoned with in attempting to control its use.<sup>2</sup>

The tradition is still operating, as illustrated by leap-frogging developments, urban sprawl, high land costs, and large profits. Delafons points out that quick fortunes are still made on the land market. "Land in Houston that was bought ten years ago for \$400 an acre can be sold today for \$4,000 or, in some parts of the city, for \$40,000."<sup>3</sup> Investigation and writing by scholars in several disciplines on the subject of land speculation is further evidence of the currency of the practice.<sup>4</sup>

<sup>1</sup> Philip Cornick, *Premature Subdivision* (New York: Columbia University Press, 1938).

<sup>2</sup> John Delafons, *Land Use Controls in the United States* (Cambridge: Harvard-Massachusetts Institute of Technology Joint Center For Urban Studies, 1962), p. 6.

<sup>3</sup> *Ibid.*, p. 6.

<sup>4</sup> A most active scholar concerned with the problem is Professor R. W. G. Bryant of the Sir George Williams University, Montreal. The author is indebted to Professor Bryant for his courtesy in permitting review of a draft copy of his text on speculation and land use control provisionally entitled *Private Property and Public Control*.

To one who is involved in the study of land speculation it soon becomes patently clear that this issue must be considered in the context of the larger issues of which it is such a vital part. These larger issues are land use practices, controls over land use, private rights, public needs, and popular attitudes concerning these matters. This article results from a study which spanned several years and which investigated the scope and effectiveness of land use controls in the United States today, with particular emphasis upon subdivision regulations.<sup>5</sup> The research highlighted the extent of speculation in land, the problems it causes, and the consequences for land use controls.

Speculation has played a beneficial role in the development of our country. The prospect of quick fortune always lures the man of means and great personal fortunes and rapid development of areas or resources or industries often results. John Delafons points out that speculation in land was not the prerogative of the rich, but was available to all comers in such an underdeveloped country.<sup>6</sup> (Delafons apparently discounted Marshall Field, who made most of his \$100 million fortune in land speculation,<sup>7</sup> as well as John Jacob Astor, asserting that none of the great American fortunes derived from real estate.)

Speculation has its malevolent aspects, however, and these seem to be generally unknown or ignored. "Unbridled land subdivision as a get-rich-quick scheme has left ugly scars on nearly every major city and many of the smaller cities in the United States."<sup>8</sup> In the fringe areas around our cities there is frenzied competition for land, and ". . . much is heard concerning speculators and/or developers who have made quick fortunes. Less is said concerning the blighted hopes or investments lost."<sup>9</sup> Even less has been heard concerning the effect of speculation on the community and its taxpayers.

From time to time, public attention is drawn to a particularly flagrant example of speculation, but . . . the general public is hardly aware of the extent to which it pays tribute, in the form of increased land prices, to

<sup>5</sup> Richard M. Yearwood, "Accepted Controls of Land Subdivision," *Journal of Urban Law* Vol. 45 (1967), p. 217, gives other findings of that research.

<sup>6</sup> Delafons, *op. cit.*, p. 6.

<sup>7</sup> "How to Get Better Land for Less," *House and Home*, August, 1960, p. 136. This entire issue is devoted to the problems of inflated land costs, speculation, sprawl, tax policy, and recommendations for better policies and better use.

<sup>8</sup> *Performance Bonds for the Installation of Subdivision Improvements* (Chicago: American Society of Planning Officials, 1953), p. 20.

<sup>9</sup> Mabel Walker, "Land Use and Local Finance," *Tax Policy*, Vol. 27 (1960), p. 3.

people who have contributed nothing to the communal good in return for their gains. It is odd how homeowners resentful of increasing taxation often say little about speculators . . .<sup>10</sup>

Most Americans do not see anything improper in making profit out of land deals. In fact, such operations are condoned. Often the speculators become minor folk heroes who are applauded for their cunning operations.

Speculative activities are concentrated in fringe areas because in these areas ". . . just beyond today's suburbia there is little planning, and the development is being left almost entirely in the hands of the builder." The fact of little or no regulation, coupled with the availability of inexpensive land, attracts the speculator. Low cost, and often low quality, houses and developments can be built. The developer understandably ". . . follows the line of least resistance, and in his wake is left a hit-or-miss pattern of development."<sup>11</sup>

The sprawl fostered by speculative practices is bad economically. It is bad for farmers, industry, utilities, railroads, recreation groups, and even for developers themselves—in short, it is bad for the whole community and the whole area.

The fringe areas continue to attract speculators. No doubt "fashion trends" lend themselves to speculative activity in the fringes. Developers are aware of the desire of many urban dwellers to change to suburban living, and they capitalize on this trend. Regardless of such "fashion trends," many developers prefer fringe area locations anyway, because of ". . . freedom to speculate in land sales without the need for heavy investments in improvements."<sup>12</sup>

## II

### The Fantastic Rate of Development

It is OBVIOUS that problems of land use planning increase in relation to the amount of development, and the rate of development in this country has been and is fantastic. Recent figures show that 3,000 acres per day are bulldozed for new development here in America. This contrasts with the approximately 30,000 acres per year developed in England and Wales, for example. Over the past five years housing production in the

<sup>10</sup> R. W. G. Bryant, "Private Property and Public Control," (manuscript, 1968) p. 1.

<sup>11</sup> William S. Whyte, "Urban Sprawl," *Fortune*, January, 1958, p. 102.

<sup>12</sup> Fred E. Case, "Private and Public Interests in Urban Dispersal," *The Nature and Control of Urban Dispersal*, ed. Ernest A. Engelbert, (Berkeley: University of California Press, 1960), p. 23.

United States has averaged 1,300,000 units per year.<sup>13</sup> This tremendous growth reflects the large—though now diminishing—quantity of land available in the country, the expanding population, the influence of the automobile and our resultant desire for suburban living, and the prosperity that allows so many Americans to own their homes. This growth also reflects the dominant American attitude concerning land use, an attitude of little concern for the rate at which land is used and a belief that all development is necessarily and inherently good, probably because someone is making money out of it.

As an astute British observer said, ". . . despite this rampant growth, it is very rare in America to encounter any antipathy to new development. Quite the opposite is usually the case."<sup>14</sup> The attitude is correctly discerned. To most Americans unfortunately, development is progress, even if the development is substandard, premature, improperly located, and a drain on the public purse.

To many Americans it seems un-American to restrict private ownership and use of land. However, as the few surveys of earlier subdivision practice have shown, ". . . unrestricted private ownership of land has encouraged an anti-social and uneconomic utilization of property in the typical American city,"<sup>15</sup> and speculation has resulted in premature, poorly planned, substandard subdivision; in the over-development of land in some concentrated areas; in development of unsuitable land, and poor location of subdivision; and in water supply and sewage disposal problems, overloaded schools, tax problems, financial difficulties, foreclosures, and all the rest.

The prevailing attitude of general unconcern for the rate at which land is being consumed by new development of various kinds is born of our collective confidence that the supply of land is somehow unlimited. This attitude has been termed "prairie psychology."<sup>16</sup>

Americans devoted to the rights of property, convinced that there was a never-ending supply of land, and adhering to the free market and the free enterprise system, have proceeded to develop their land in their own way, displaying a formidable antipathy to any governmental control over private development.

<sup>13</sup> Delafons, *op. cit.*, p. 5.

<sup>14</sup> *Ibid.*, p. 5.

<sup>15</sup> "Public Land Ownership," *Yale Law Journal*, Vol. 52 (1942-43), p. 634.

<sup>16</sup> Delafons, *op. cit.*, p. 6.

The dominant feeling has been that land uses are most efficiently organized if the decisions are made by the market. The "market," however, is not some abstract entity. It is made up of people; some of them are unsuspecting, uninformed purchasers, some of them are ethical developers, some of them are speculators, and some apparently are just crooks.

The market mechanism in real estate is imperfect. Else, how did developers in the state of Florida offer in the Twenties enough lots to provide for the total United States population? Radical upward movements in price levels historically have been associated with premature and excessive subdivision. This overproduction results ultimately in price collapse. It also results in improper land development. Many of our cities actually have a large amount of vacant land in and around them.<sup>17</sup> However, it is difficult to use this land, much of which was prematurely subdivided during speculative periods. Thus speculation and unwise development practices in the past hurt our communities today because of the wasteful and inefficient patterns of use imposed on the land.

Land use decisions have been made solely (until very recent times) by private individuals—the real estate dealers, the land developers, and the bankers, all of whom were interested in making a profit. Adrian stated that "19th century Americans did not believe that a greater community interest stood above that of the profit motives of these men."<sup>18</sup> Popular opinion in America still favors private profit over community interest.

### III

#### Land Speculation in the 19th Century

LAND SPECULATION in the 19th century is of great interest because it indicates the pervasiveness of a tradition that so many Americans hold dear today and on whose behalf they vigorously oppose control. Delving into the historical aspects of this phenomenon also exposes its weaknesses and the harm it often works on individuals and communities.

It is true that "Many of America's biggest panics and depressions were touched off by over-speculation in land and a bust in land prices that carried hundreds of banks and other lending institutions down with it."<sup>19</sup>

<sup>17</sup> *House and Home*, *op. cit.*, pp. 106-13.

<sup>18</sup> Charles R. Adrian, *Governing Urban America*, 2nd ed. (New York: McGraw-Hill, 1961), p. 457.

<sup>19</sup> *House and Home*, *op. cit.*, p. 123.

Cornick speaks of the speculation and premature subdivision that occurred in the early part of the 19th century:

In 1825, the first boat traversed the entire length of the canal from Buffalo to Albany . . . The incentives to premature subdivision . . . at once came into play, and urban lots began to grow in numbers even more rapidly than the population.<sup>20</sup>

In this respect it seems that there has been little change from 1826 to the present. The supply of "urban" lots still exceeds demand.

There were notable booms in real estate in New York in 1835 and 1865, as well as in the 1920's. Each of the earlier booms was also followed by a bust, occurring in 1837 and 1873, respectively.<sup>21</sup>

A good account of what occurred in these booms and busts is recorded in the diary of Phillip Hove, who observed that "The rage for speculating in land on Long Island is one of the bubbles of the day. Men in moderate circumstances have become immensely rich. . . ."<sup>22</sup> Hove pointed out that " . . . real estate is high, beyond all the calculations of the most sanguine speculator. Immense fortunes have been made and realized within the last three months."<sup>23</sup>

Another observer adds this comment on land speculation during the same period:

The City of New York not only displayed unwonted activity of trade in all its channels, and a great increase of public and private buildings, but also furnished capital for like enterprises elsewhere, even to the laying out of streets and avenues in imaginary cities expected to spring up in remote districts, to thrive by trade and manufacture not yet created, and to be occupied by inhabitants not yet born.<sup>24</sup>

The attitude may seem a trifle sarcastic, but the observer was more sensible and more realistic than many people during that period. He anticipated the bust that occurred shortly thereafter.

New York State was not an isolated pocket of speculation. Speculative activity has existed at various times in all parts of the country. Monchow showed that there were also booms and busts in the Chicago area over a protracted period of time. There was the "canal boom" in 1836, the "boulevard boom" in 1872, the "electric line boom" of 1890, and the "rapid transit boom" of 1926. These were the major periods

<sup>20</sup> Cornick, *op. cit.*, p. 5.

<sup>21</sup> *Ibid.*, *passim*.

<sup>22</sup> Philip Hove, *The Diary of Philip Hove* (New York: Dodd-Mead and Company, 1889), Vol. 1, p. 131.

<sup>23</sup> *Ibid.*, p. 139.

<sup>24</sup> William H. Seward, *Autobiography* (New York: D. Appleton and Company, 1877), p. 315.

of activity which led to the creation and existence by 1939 of 2,000,000 vacant subdivided lots in Chicago—enough to accommodate 15,000,000 people, or triple the city's population at that time. Miss Monchow found that “. . . further scrutiny . . . shows that speculative appeals . . . have supplied the impetus for the successive waves of subdividing activity which have swept over the area.”<sup>25</sup> These speculative appeals were made in many cases by fly-by-night operators who bought land at low prices, or operated on the basis of options to buy, subdivided on paper, sold some lots quickly, and got out.

Usually in their earlier era of speculation the promoter had little or no investment in the land. His sales produced clear profits for him. The owner, however, was left with a piece of land with higher assessments and only a few lots sold off. Often the end result was a tax sale. Then the “. . . white elephant became the burden of the city, county, or state, and the taxpayers were the losers.”<sup>26</sup>

In the recent past, particularly in the decade of the Thirties, tax delinquency and foreclosure rates have often been staggering. These 1936 figures for Buffalo, New York, emphasize the results of speculation and premature subdivision: 92 per cent of the lots in recorded subdivisions were vacant, 45 per cent of assessed values were on vacant lots. A similar situation existed in Detroit,<sup>27</sup> and doubtless in many other cities.

Phillip Hove's diary indicates the end result of the speculation of 1835. His entry for April 21, 1937, tells us that:

The immense fortunes which we have heard so much about in the days of the speculation have melted away like the snows before our April sun. Further evidence of the pecuniary distress which pervades the community is to be found in the reduced price of stock and unimproved real estate. . . . As to lots which have been the medium of enormous speculations . . . lots which cost last September \$480 a lot have been sold within a few days at \$50.<sup>28</sup>

As Gaffney stated so well, “There has been an ebb and flow . . . a sort of manic-depressive alternation in the national mood. Expansion had outdone itself, followed by a bust. ‘In God we trusted, in Kansas we busted’ is an oft-told tale.”<sup>29</sup>

<sup>25</sup> Helen C. Monchow, *Seventy Years of Real Estate Subdividing in the Region of Chicago* (Evanston: Northwestern University Press, 1939), p. 1.

<sup>26</sup> John Horack and Val Nolan, *Land Use Controls* (Chicago: Callahan, 1955), p. 204.

<sup>27</sup> *Ibid.*, p. 205.

<sup>28</sup> Hove, *op. cit.*, p. 140.

<sup>29</sup> Mason Gaffney, *Containment Policies for Urban Sprawl*, Governmental Research Series No. 27 (Lawrence: University of Kansas Press, no date), p. 12.

The result is inevitably the same, whether it is expressed in terms of reduced prices for lots or in long rows of vacant houses. The damage to individuals and to communities is often heavy.

## IV

## 20th Century Attitudes

WE AMERICANS have modified somewhat in recent years our traditional feelings about land speculation. It took a gigantic boom and bust to alert us to the many dangers of unrestricted development and to establish a sympathetic climate for land subdivision controls. Such controls are the most significant technique available to prevent such malevolent practices. It is a fact that

. . . subdivision controls were not thought of as a means of limiting the amount of development until the vast land speculations of the 1920's showed the folly and ruinous expense to local governments of unrestricted subdivision. In this decade, when zoning controls were being adopted, practically no control was exercised over the amount of land seized for development. In Florida enough land was subdivided to house the population of the entire United States.<sup>30</sup>

Bizarre promotional schemes involving "residential lots" were legion.

In Northern Westchester County in New York State and along the New Jersey Coast, thousands of twenty-foot lots were distributed by newspapers to new subscribers. The result was that vast quantities of land on the outskirts of every large town and city were roughly hewn up for development with jerry-built houses and without proper roads, water, schools and other city services. The wastage of land was appalling.<sup>31</sup>

If it seems strange to the reader that small lots were given by newspapers as prizes to new subscribers, there were even stranger promotional stunts. Cornick tells that during the boom of the 1920's the speculators ". . . relied on high pressure salesmanship and on devious devices to sell their lots. In one case, deeds were given away as premiums with boxes of soap." It goes without saying that cheap land was thus dispensed in order to prime the pump. The land so offered was of little or no value to start with. In twenty-foot lots it was useless for building purposes, and, as one would expect, the lots showed a "high mortality rate as taxpayers," thereby adding to the financial load of the county in which they were located.<sup>32</sup>

<sup>30</sup> Delafons, *op. cit.*, pp. 25-6.

<sup>31</sup> *Ibid.*, pp. 25-6.

<sup>32</sup> Cornick, *op. cit.*, p. 168.

Another factor that added to the financial troubles of counties and municipalities was default on many kinds of bonds issued to aid development.

Bonds, whether railroad aid, irrigation, drainage district or special assessment, have all too often been issued in aid of the real estate speculator or promoter, so much so that a large portion of all municipal debt difficulties could be summed up under the caption "real estate aid bond defaults."<sup>33</sup>

This problem is a very real one for many of our municipalities today. All too often one finds that a city has issued bonds and obligated itself unduly in order to provide services and facilities to new subdivisions. These are services and facilities that the developer, not the city, should have furnished.

Speculation leads to waste of a valuable resource. There is waste in taking land out of a productive use before it is ready for another; waste in tying up capital for long periods in an unproductive enterprise, with more in taxes, interest, and special assessment; waste in the division of land into lots that are too small, or poorly designed, or poorly located; waste in zoning too much for business use; and waste in replatting land which has been prematurely subdivided. There are other wastes too: increased utility costs, increased maintenance costs, and increased overall governmental costs, all of which affect the community adversely.

America is beginning to mature. As our cities have begun to deteriorate and their populations to flee to the suburbs, as we begin to realize that the supply of land is *not* limitless, as the full effect of our past practices in the use of land become visible and even almost unbearable, we are beginning now to change our attitude toward regulation of land use. It is not a complete change in American attitude; rather, it is a change in the dominant pattern of thought. History indicates that though one concept may be dominant in a society, it usually has an antithetical concept, held by a small minority, which seems dormant. In time, of course the opposing view may gain the ascendancy. This is what is happening now in America with reference to our ideas about land development and use.

## V

### Free Enterprise and Land Use Regulation

EVEN THOUGH THE MAJORITY VIEW in the 19th and early 20th centuries was strongly opposed to government control over any part of the

<sup>33</sup> Albert M. Hillhouse, *Municipal Bonds* (New York: Prentice-Hall, Inc., 1936), p. 67.

economy, and even though majority thought during the first decades of the 20th century opposed any governmental regulation of land use, a current of thought favored regulation. And it is a point of view that has hoary precedent. The fact is that the government has exercised "continuous and often elaborate control" over many aspects of private development since the earliest colonial days.<sup>34</sup>

The land use controls that do exist in this country today, despite ancient antecedents, cannot be traced to an overwhelming preference for planning or the planned community.<sup>35</sup> There is nothing idealistic or utopian about the controls we do have. Their origin is not in any theory of city planning, but in the common law of nuisance and in the public statutes regulating noxious industries.

The controls that we possess have largely grown out of a desire to protect our property, not only from government interference but from other private property as well. Our regulation of the location of certain uses and industries in order to protect our property from possible damage, as in the case of gun powder storage, or from noxious odors, as in the case of a tanning yard, go back beyond American colonial experience at least to Roman law.<sup>36</sup> The regulations of land use that we do have were adopted *seriatim* over a long period of years. There was no drafting of a systematic theory or plan to control all land use. Instead regulations were made on an *ad hoc* basis as changes and new developments required.

### *Zoning*

The "system" that we now have for regulating private development—zoning—is a product of the Twenties, the apex of free enterprise thought in this country. Zoning, which controls the uses a private individual may make of his land, cannot be understood without going back to discover the motives that led to the establishment of the system.

It may seem incredible that a system for regulating private use of land could be accepted at the time when the free enterprise concept was at its zenith, but zoning was accepted, widely accepted, in the Twenties. The extent of its popular acceptance is shown by the fact that in 1919, only 20

<sup>34</sup> Delafons, *op. cit.*, p. 18.

<sup>35</sup> Some communities were founded with the intention of planning their development, but these plans were often disturbed by later growth. Examples of these are Washington, D. C., Savannah, Ga., Madison, Wisc., Williamsburg, Va., and Annapolis, Md.

<sup>36</sup> Charles A. Rathkopf, *The Law of Zoning and Planning*, 3rd ed. (New York: C. Boardman Co., 1956), Vol. 1, p. 1.

cities in the United States had zoning ordinances, but 973 cities had them by 1929.<sup>37</sup>

Zoning was accepted in the United States not because the general public was in sympathy with governmental regulation and wanted more of it, but because the property owners in this country wanted to be protected from each other. Zoning seemed a good, sound, conservative device to protect private property. By restricting locations and uses of land, zoning would protect property values. Many of those who support zoning today do so only on this understanding of its purpose.

### *Subdivision Regulation*

In the 1960's Americans may be ready for another kind of governmental control of land use, one that will protect property owners and cities and taxpayers from economic loss. That control is subdivision regulation, which planning commissions began to introduce in the Sixties. It not only can protect us from economic loss; it can protect us from social waste as well. The American people must see it as a tool generally like zoning, but one that is more important than zoning in rapidly developing areas because it can be utilized to set the pattern of development.

This writer has to agree with the student who said that "In theory, almost everyone (except the land speculator) stands to benefit from the introduction of zoning and subdivision control."<sup>38</sup> Many think this would be true in practice as well as in theory. The speculator would not benefit from such control, but the average developer would, because his development would possess an appeal that would attract purchasers.<sup>39</sup> So, if the developer wants to sell his houses and make a profit on his investment, he owes it to himself to make his development attractive to potential purchasers. If the subdivider plans to remain in the development business in that area, he owes it to himself to make his developments solid and sound and as well planned as he can, so that they will not deteriorate and depreciate rapidly, thus damaging his reputation as a developer.

The trend seems to be in the direction of more "professional" developers who, over a period of time, bring in several subdivisions. As

<sup>37</sup> Charles M. Haar, *Land-Use Planning* (Boston: Little, Brown and Company, 1959), p. 165.

<sup>38</sup> Delafons, *op. cit.*, p. 82.

<sup>39</sup> *Planning Profitable Neighborhoods*, Federal Housing Administration Technical Bulletin No. 7 (Washington: U. S. Government Printing Office, 1939), p. 3.

these developers realize what good subdivisions mean to them personally, the quality of our development may improve. A gradual program of education and enlightenment will be required to achieve this end. But there can be no doubt that successful subdivisions are founded on intelligent planning and the adoption of sound programs for controlling development.

## VI

### Conclusion

THE MISUSE AND UNDERUSE OF LAND and the evils of uncontrolled speculation in land are urgent problems in many parts of the world. It has been said that land speculation is "Public Enemy No. 1" of the home-buying public and the home-building industry in America.<sup>40</sup>

How to reduce or prevent speculation? "The only cure for land speculation is to eliminate the extraordinarily favorable tax treatment now accorded the land speculator," according to Professor John Henry Denton:

No justification for this can be found in economic theory. Unlike speculation in commodity futures or common stocks, land speculation does not support a market or provide a stimulus to production. In fact, it has just the opposite effect. It destroys large areas of land by pricing them out of the reach of immediate users. It deprives our communities of many facilities needed for good living (such as parks and playgrounds) by driving the price of land beyond what communities can afford. It limits competition by holding a large part of the land supply off the current market.<sup>41</sup>

Our tax system grants this nonproductive, destructive activity the most favorable tax treatment of any. Land as land is hardly taxed at all. Instead, our tax system aids speculation and sprawl because (1) underassessment makes it cheap and easy for speculators to hold land for years; (2) land speculation profits are taxed not more than half as heavily as ordinary income, with a maximum rate of 25 per cent; (3) most states do not permit local governments to tax land more heavily than they tax improvements; (4) land carries a much smaller share of the realty tax load than ever before; and (5) even the small tax on land is deductible from federal and state income taxes (and corporate taxes).<sup>42</sup>

We must change our tax policies if we are to reduce speculation. The

<sup>40</sup> *House and Home*, *op. cit.*, p. 126.

<sup>41</sup> *Ibid.*, p. 137.

<sup>42</sup> *Ibid.*, p. 139.

idea most often advanced is to tax land as land. "Heavy taxation on land values would increase substantially the holding costs of land, and thus encourage more intensive utilization," according to a comment in *Nation's Cities*.<sup>43</sup> Professor Lindholm speaks of "land value taxation" and reiterates the claim that such taxation will exert continuing pressure to use land more efficiently.<sup>44</sup> Professor Gaffney advances the same notion, which he terms a "site-capacity tax," in a well written article on urban sprawl.<sup>45</sup>

If we adopted a policy of taxing land as land, according to its value, the public would recoup part of the incremental value, at least that which is caused by public improvements. To make this work, assessments would have to keep pace with market values, of course. The people of several other nations have realized that "Land speculation essentially is trafficking in values created by the community in general, not by the owners."<sup>46</sup> We must realize that the landowner does nothing to increase the value of his land; the increase is due to urbanization, to the development of the whole community. Yet the land speculator can profit immensely because of large expenditures on public improvements that make his land so valuable. Most suburban land would be of little value if it were not for the roads and highways, the utilities, the schools and other community facilities provided by the public. These kinds of improvements cost so much money that speculation would be much less profitable if the speculators had to pay for them.<sup>47</sup> We should stop subsidizing expansion and speculation.<sup>48</sup>

The reckless extension and expansion of community facilities that so favor the speculator must stop. One means to achieve this control is subdivision regulation. This land use control device is not a panacea; by itself it will not completely prevent speculation. However, tough subdivision regulations which require the developer to put in all necessary physical improvements, including streets and utilities, and which require him to dedicate land for parks and schools would shift the cost of providing such improvements from the local government to the developer and then to those who ultimately benefit therefrom, the buyers of houses and lots

<sup>43</sup> "What Kind of Cities Do We Want," *Nations' Cities*, April, 1967, p. 34.

<sup>44</sup> R. W. Lindholm, "Land Taxation and Economic Development," *Land Economics*, Vol. 41, No. 2 (May, 1965), p. 126.

<sup>45</sup> Gaffney, *op. cit.*, pp. 17-8.

<sup>46</sup> R. W. G. Bryant, "The Importance of Adequate Social Organization," *Zoning Digest* Vol. 18 (1966), p. 121.

<sup>47</sup> *House and Home*, *op. cit.*, p. 142.

<sup>48</sup> Gaffney, *op. cit.*, pp. 13-7.

in these developments. Such regulations exist in many parts of the country today. To be really effective in the fight against speculation, these regulations should be adopted and enforced by every town and county in America.

In the long run we shall have to modify our popular thinking in many ways. We shall have to cease thinking of land as merchandise, as a commodity. We shall have to revise our tax policies also. These changes do not appear imminent. In the interim before their realization, our communities must regulate land subdivision in order to provide good design and the necessary physical improvements, and thus reduce speculation in land and contribute to orderly urban growth.

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### *Community Development in Thailand*

THAILAND'S 6-year-old Mobile Development Unit Program to improve the living conditions of the rural people and to counter Communist insurgency had 20 units in 20 provinces by mid-1968 and more are being added at the rate of three a year. The newest M.D.U. is at Rajburi, about 80 miles southwest of Bangkok. M.D.U. self-help projects for Rajburi include: building or improving 130 miles of roads; digging 15 ponds, each to serve 500 people; building three new schools and improving a fourth; digging at least six wells, each to serve 500 people; organizing the youth, teaching leadership, and initiating a small dam and reservoir project. The Thais spend the equivalent of nearly \$5 million on the M.D.U. program each year. Economic and military assistance to the M.D.U. program by the Agency for International Development has totaled about \$5.5 million since 1963. [From the U.S. Department of State.]

### *Two Rural Americas*

THERE ARE TWO rural Americas, according to Secretary of Agriculture Freeman: (1) Fine old farmhouses, tall corn, fat livestock, and elm-lined village streets; (2) back in the mountains, hollows, and swamplands away from the concrete highways, a proportion of poverty twice as high as in cities and their suburbs.

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# Territorial Differentiation and Societal Change in the United States and Canada\*

By SANFORD LABOVITZ and ROSS PURDY

**ABSTRACT.** A theory based on four stages of social and cultural changes for large territorial units is presented and three hypotheses are deduced linking territorial differentiation to societal change. The stages are measured by the degree to which the territorial units of a society display similar characteristics, and whether the units are diverging or converging from one another. Hypothesis I asserts that the form of societal change among territorial units over time is curvilinear. Hypothesis II maintains that changes in technological efficiency lead to changes in territorial differentiation on selected social and cultural characteristics. Finally, according to Hypothesis III, changes in territorial differentiation on technological efficiency are directly related to changes in territorial differentiation on selected social and cultural characteristics. The hypotheses are tested in terms of changes in the United States and Canada and receive strong support from the direction and magnitude of the relations.

## I

### Introduction

A THEORY LINKING territorial differentiation to societal change is formulated in this paper and three hypotheses are tested on changes in the United States and Canada.<sup>1</sup> Tests of the hypotheses are based on an extended analysis of changes in the U.S. (the time span for some variables is 1790–1960) and Canada (usually in the period 1901–1961). Moreover, techniques of time series analysis are employed on census data for territorial units. The theory provides an empirical basis for temporal and cross-cultural comparisons, because it is based on measurable variables that can differentiate among societies, and distinguish between one stage of societal change and another.

To illustrate some of the implications of the theory, note the impressionistic territorial changes in the U.S. since the early European settlers. Industrial development and regional differentiation probably began in the colonial period, when specialization developed along the Eastern seacoast.

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<sup>1</sup> In a previous paper part of the theory was presented and supported by a limited study of changes in the U. S. from 1900–1950: Sanford Labovitz, "Territorial Differentiation and Societal Change," *Pacific Sociological Review*, Vol. 8 (Fall, 1965), pp. 70–75.

Ocean trade, shipbuilding and fishing concentrated in the New England colonies, while the middle and southern colonies specialized in selected agricultural products. At this time the seacoast area in the East was much more developed than the Midwestern or Western parts of the United States. Consequently, a high degree of territorial differentiation existed, which was reflected in vast differences in the social and cultural life styles of the territories. As people migrated and industry expanded, a large part of the country developed and a point was reached where the wide differences in life style diminished. This pattern of great initial differences among territories that diminish with increasing industrialization is an example of both qualitative and quantitative forms of change and illustrates the importance of technological development. The theory presented below conceptualized these changes, and states the conditions under which large territorial units should follow them.

## II

### Statement of the Theory

THE THEORY IS CONCERNED primarily with organization and change at the societal level, and is based on the degree of interdependence among territorial units, *i.e.*, territorial differentiation.<sup>2</sup> This study, for example, considers changes among the regions of the U.S. and the Provinces of Canada. Territorial differentiation on an economic basis refers to technological differences, such as productivity. The measurement of productivity yields quantitative values, which range on a continuum from nearly equal to large differences among territories.

Crucial to the theory are formulations about technology, social organization, resources, and population. These four concepts are stressed in two current delimitations of the field of human ecology.<sup>3</sup> Moreover, the emphasis on social and cultural changes (*e.g.*, education, marriage, fertility, income, voting behavior, technology, and industry) clearly indicates

<sup>2</sup> Some economists call this technological dualism. See, for example, Benjamin Higgins, *Economic Development* (New York: W. W. Norton and Company, Inc., 1959), pp. 325-33; "The 'Dualistic Theory' of Underdeveloped Areas," *Economic Development and Cultural Change*, Vol. 4 (January, 1956), p. 106; and Gerald M. Meier, *Leading issues in Development Economics* (New York: Oxford University Press, 1964), pp. 68-74. For a recent empirical study of technological dualism among countries see Jeffery G. Williamson, "Regional Inequality and the Process of Natural Development: A Description of the Patterns," *Economic Development and Cultural Change*, Vol. 13, Part II (July, 1965).

<sup>3</sup> Jack P. Gibbs and Walter T. Martin, "Toward A Theoretical System of Human Ecology," *Pacific Sociological Review*, Vol. 2 (Spring, 1959), pp. 29-35. Otis D. Duncan and Leo F. Schnore, "Cultural, Behavioral, and Ecological Perspectives in the Study of Social Organization," *American Journal of Sociology*, Vol. 65 (September, 1959), pp. 132-46.

the closeness of certain notions in the theory to ideas espoused by Marx, Colin Clark, Godfrey and Monica Wilson, Durkheim, Spencer and Ogburn. The following theory can be differentiated from formulations developed by these individuals not so much in terms of concepts, ideas and relationships, but by its explicit nature and empirical orientation.

Based on territorial differentiation, the theory is divided into four hypothetical stages.<sup>4</sup> Implicit in the stage scheme are some causes and effects of changes in territorial differentiation. The theory considers (1) the effects of technological change, and (2) relations among a country's territorial units with regard to social and cultural characteristics.

Stage I. Territorial differentiation is nonexistent in Stage I.<sup>5</sup> The society is completely rural and each of its territorial units is economically independent and exhibits similar social and cultural characteristics. Technology is simple, based on animate energy sources,<sup>6</sup> and is not sufficient to produce a surplus of goods and services for trade.

Stage II. Stage II marks the onset of technological change and the concentration of population in one or a few areas. Cities develop, but the rural areas remain economically independent, and social and cultural characteristics between the urban and rural areas increasingly diverge. The increasing level of technology is territorially contained and affects only the area in which it is located. Territorial differentiation<sup>7</sup> increases as the urban areas develop and rural areas do not (or develop at a slower rate). The technology is developed sufficiently to permit a surplus, which leads to the *intra*-territorial exchange of goods and services.

Stage III. Technological changes cross the boundaries of the developing areas and begin to pervade the whole society. The rural areas specialize and develop, and the territories become more economically interdependent. Consequently, the areas converge on social and cultural characteristics. Rural productivity becomes increasingly closer to urban productivity, and therefore, differentiation decreases among the areas.

Stage IV. The logical extreme of this process is complete economic interdependence among the territories, all of which display similar char-

<sup>4</sup> Labovitz, *op. cit.*, p. 72.

<sup>5</sup> Stage I is only approximated today and probably is more characteristic of pre-historic times.

<sup>6</sup> For a description of low-energy societies see Fred Cottrell, *Energy and Society* (New York: McGraw-Hill, 1955), ch. 2; and C. Daryll Forde, *Habitat, Economy and Society* (New York: E. P. Dutton and Company, Inc., 1934).

<sup>7</sup> Conceptually, differentiation subsumes two related processes, *i.e.*, interdependence and integration. Interdependence refers to an exchange of goods and services between groups that may or may not be culturally distinct. Integration, on the other hand, denotes a cultural overlap between groups that share, at least in part the values and norms of a society.

acteristics. As in Stage I, the logical extreme shows no differentiation because there is equal productivity in all areas.

Implicit in the description of the stages are three testable hypotheses. *Hypothesis I* asserts that, given technological changes, the *form* of societal change over time is curvilinear in terms of the degree of economic differentiation among territories, *i.e.*, economic differentiation first increases and then decreases among territories. Consequently, the territories diverge in Stage II by becoming increasingly dissimilar economically and converge in Stage III by becoming increasingly similar.

*Hypothesis II* stipulates that changes in technological efficiency lead to changes in territorial differentiation on other social and cultural variables. That is, certain technological changes are both necessary and sufficient for territories to diverge or converge on selected characteristics. There are two corollaries to the hypothesis: (A) in Stage II, technological efficiency is directly related to territorial differentiation on social and cultural variables, and (B) in Stage III, it is inversely related to these variables.

*Hypothesis III* is stated formally as follows: territorial differences in technological efficiency are directly related to territorial differences on other social and cultural variables. For example, as the regions of the U.S. become less technologically differentiated, differences in marriage patterns, industry structure, education, voting behavior, and fertility decrease.

The rationales for *Hypotheses I, II, and III* are based on the following line of reasoning. As technology develops from simple to complex (in terms of the number and variety of tools and machines, and the knowledge necessary for their operation), some areas in a society specialize and, concomitantly, their populations begin to concentrate. At first, population concentration is confined to a particular territory (*e.g.*, region or province), and the more urban places in the territory are supported by the agricultural production of their immediately surrounding rural hinterland. At this stage it is assumed that technological development takes place selectively, because natural resources and trade routes favor certain areas.<sup>8</sup>

More efficient technology and increased urbanization are followed by several other changes within the selected area: for example, life expectancy increases, the standard of living increases, personal possessions and

<sup>8</sup> For a discussion of the locational aspects of economic development see Carl C. Madden, "Some Temporal Aspects of the Growth of Cities in the United States," *Economic Development and Cultural Change*, Vol. 6 (January, 1958), p. 159; Douglas C. North, "The Spatial and Interregional Framework of the U.S. Economy," *Papers and Proceedings*, (The Regional Science Association, 1956), Vol. 2, p. 201; T. W. Schultz, *The Economic Organization of Agriculture* (New York: McGraw-Hill, 1953), p. 147.

formal education increase, fertility rates decrease, and the society becomes more secular in nature. These changes only occur in territories experiencing technological change and increasing urbanization. Consequently, as technological efficiency increases, the differences between territorial units increase, *i.e.*, *Corollary A, Hypothesis II*. Further, as differences in technological efficiency between territories increase, differences between the territories on other characteristics increase, *i.e.*, *Hypothesis III*.

As technological efficiency and urbanization continue to increase, the developing areas extend their influence. This occurs by way of increased contact between the rural and urban areas through the improvement of transportation and communication. Consequently, the less developed territories become increasingly influenced by technological innovations and the "urban-way-of-life." In areas experiencing technological changes laborers are needed and many of these migrate from the rural territories, attracted by increasing economic opportunities. Therefore, internal migration (rural or urban) becomes prevalent, and extensive diffusion of material goods, ideas, values, and norms occurs. Both urban and rural areas in all territories change. To support a concentrated non-agricultural population, the urban areas need an increased food supply, most of which comes from the rural agricultural areas. But the rural areas must increase their productivity to provide a surplus for trade with the cities. Therefore, agriculture begins to mechanize and specialize. Consequently, in Stage III, as technological efficiency increases, territorial differentiation decreases, *i.e.*, *Corollary B, Hypothesis II*. The line of reasoning for *Corollaries A and B* also supports *Hypothesis I, i.e.*, the form of change in territorial differentiation is curvilinear. *Hypothesis III* is the same for Stages II and III. In Stage II, it is hypothesized that territorial differences for both technological efficiency and other variables increase, while in Stage III both decrease.

Implicit in the theory are certain conditional statements and assumptions. First, it is not assumed that all societies sooner or later necessarily go through the four stages.<sup>9</sup> It is hypothesized that societies will go through the stages only if technological efficiency increases. If a decrease should occur, the prediction is a reversal in the stage sequence. Moreover, the theory would predict a "stagnant" society if it did not experience changes in technological efficiency.

<sup>9</sup> Since there is not inevitable change from one stage to another, it may be questioned whether the theory is evolutionary. It may be evolutionary in the sense that the stage scheme represents changes in the direction of increasing complexity in terms of societal differentiation. But, a society theoretically may follow a reversed sequence of stages and, therefore, become less differentiated.

Second, in its ideal form the stages apply only to societies that (1) are completely isolated and self-sufficient, that is, not affected by foreign trade or external migration, or (2) are developing, at least initially, through labor-intensive techniques. Therefore, in a pure sense, the theory could apply to a null class. It is assumed, however, that a society approximates the stages to the degree to which it is independent of external influence or started with predominantly labor-intensive techniques. If external influence is in terms of capital-intensive investments, a society may not change in the way suggested by the stage scheme. Capital-intensive techniques create few employment opportunities for unskilled labor and, therefore, do not create the necessary economic opportunities for extensive rural-urban migration.<sup>10</sup> Consequently, contact between territories need not be extensive. It seems reasonable to assume that a relatively self-sufficient society adopts labor-intensive techniques at first; and gradually, as technology changes from simple to complex, more capital-intensive techniques are used.

Third, the stages are not discrete, but represent arbitrary divisions of a continuum. Note that territorial differentiation follows a curvilinear stage sequence: in Stage I differentiation is nonexistent; it increases in Stage II, reaching its zenith at the end of the period; the process reverses in Stage III and differentiation among areas continually decreases until Stage IV, where again it is nonexistent. The curvilinear progression is diagrammed in Figure 1. Although Stages I and IV are both postulated to have no territorial differentiation, there are two major differences between them: (1) there are vast changes in social and cultural characteristics, and (2) the society is economically integrated in Stage IV, whereas in Stage I it was composed of independent units.

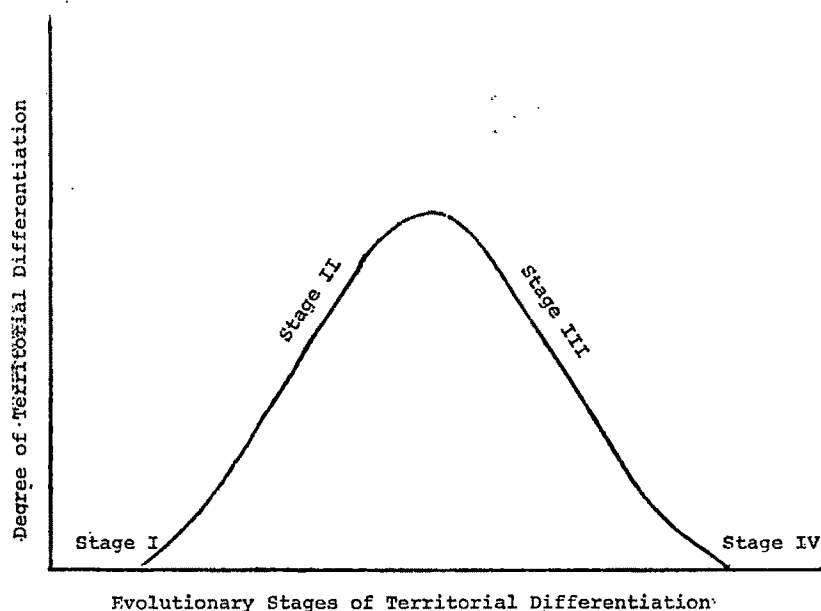
Finally, the spread of technological changes, which is essentially the diffusion of the "urban-way-of-life," is hypothesized to cause social and cultural similarities among areas in Stage III. However, territorial specialization in industry may act as a counter influence on the process. As differentiation decreases, the territorial units become increasingly similar on per-capita productivity, but their organization of economic activities may not be the same. Several differences are apparent among the organizations of large-scale farming, automobile manufacturing, and fishing industries.

There are three reasons why territorial specialization is not expected to counteract the influence of technological innovations. First, all industries

<sup>10</sup> However, such migration can occur through "push" factors off the land.

(primary, secondary or tertiary) develop through technological innovations, which are assumed to equalize the "wealth," "productivity" or "income" among the territories. Therefore, no matter what the industrial

Figure 1. Evolutionary Model of Territorial Differentiation



specialty (or specialties) may be, the "level of living" depends upon technological innovations. Second, although industrial specialization on a territorial basis may initially increase, it may decrease with regard to certain industries in Stage III. For example, tertiary industries may become increasingly alike among the territories, while primary industries specialize more and more because of their dependence on natural resources or favorable locations in terms of transportation routes or access to a labor supply. Finally, it is assumed that technological innovations and urban patterns have the dominant effect, even though industry specialization may force certain differences among the territories. Despite these reasons, territorial specialization and differences in economic organization appear to be important variables for future study, and may account for deviations from the theory.

## III

## Method

THE HYPOTHESES ARE TESTED with regard to changes in the territorial divisions of the U.S. and Canada. These countries were selected for analysis because the necessary data are available for an extended period of time. The divisions used in the U.S. are the nine geographic regions delimited by the U.S. Bureau of the Census: New England, Middle Atlantic, East South Central, West South Central, South Atlantic, East North Central, West North Central, Mountain and Pacific.<sup>11</sup> Nine provinces in Canada are used: Prince Edward Island, Nova Scotia, New Brunswick, Quebec, Ontario, Manitoba, Alberta, Saskatchewan, and British Columbia. The provinces of Northwest Territories, the Yukon and Newfoundland are excluded. Newfoundland has not been a province long enough for analysis, while lack of certain requisite data eliminated Northwest Territories and the Yukon from the study. However, their populations are so small, they are not likely to effect the analysis.

To test the hypotheses, urbanization is used as an index of technological efficiency, as direct measures of technological efficiency for the periods in question are not available for the regions of the U.S. or the provinces of Canada. There is ample evidence, however, that urbanization is an adequate indicator of technology in both longitudinal and cross-cultural studies.<sup>12</sup> Data on urbanization for territorial units are from 1790–1960 for the United States, while for Canada the period is 1901–1961.<sup>13</sup>

Fourteen social and cultural variables are correlated with changes in urbanization and urban territorial differentiation. They are education, married females, fertility, the sex ratio, age dependency, working females, primary industry, secondary industry, tertiary industry, establishment size, value added, income, racial composition, and voting behavior. The defi-

<sup>11</sup> Hawaii and Alaska are excluded because they have not been states long enough for analysis.

<sup>12</sup> Labovitz and Gibbs found urbanization to correlate substantially with two measures of technological efficiency: production and energy input. Sanford Labovitz and Jack P. Gibbs, "Urbanization, Technology, and the Division of Labor: Further Evidence," *Pacific Sociological Review*, Vol. 7 (Spring, 1964), pp. 3–10. High correlations were found in cross-cultural comparisons by Jack P. Gibbs and Walter T. Martin. See their article, "Urbanization, Technology, and the Division of Labor: International Patterns," *American Sociological Review*, Vol. 27 (October, 1962), pp. 667–77. Finally, in a factor analysis of change variables in the U.S., urbanization was found to cluster with an industrial-technological component. See Francis R. Allen and W. Kenneth Bentz, "Toward the Measurement of Sociocultural Change," *Social Forces*, Vol. 43 (May, 1965), pp. 522–32.

<sup>13</sup> For the U.S., in general, urban refers to that part of the population living in incorporated places containing 2,500 people or more. This is the old urban definition used before 1950 by the U.S. Bureau of the Census. The definition of urban for Canada is the population living in incorporated places.

nition and period of analysis for each variable are given in the footnotes in Tables 3 and 4. Adequate time series for Canada were not available for income, racial composition, and voting behavior. Most variables for Canada are analyzed in the period from 1901-1961. With regard to the U.S., data on each variable are considered as far back in time as they are available and maintain a comparable definition.

The index of dissimilarity (ID) is used to measure the degree of territorial differentiation in each country on a particular variable.<sup>14</sup> The ID has the virtue of not being unduly effected by extreme scores and has a clear interpretation for the data in question. The formula for the index is  $\sum |X_{ij} - Y_{kj}|/2$ , where  $X_{ij}$  is the percent of the individuals possessing characteristic  $i$  in territorial unit  $j$ ; and  $Y_{kj}$  is the per cent of individuals not possessing the characteristic (or the per cent of the total population) in territorial unit  $j$ . The statistic is interpreted as the minimum percentage of individuals with characteristic  $i$  who would have to move from one territorial unit to another to bring about an equal distribution of individuals with characteristic  $k$  among the territorial units. For example a value of 20 on sexual composition indicates that 20 per cent of the males (or females) would have to redistribute from one territorial unit to another to bring about an even territorial distribution on this variable.

Correlation and time series analyses are performed on the variables. Spearman's *rho* coefficient is used exclusively as the relationship measure for two reasons: (1) the  $N$  is usually small, ranging from 4-18, and (2) partially due to the small  $N$ , the assumption of linearity cannot be judged adequately, which eliminates use of the Pearsonian correlation coefficient.

Besides running direct correlations over time (*i.e.*, the values of the independent and dependent variables are paired off in the same census year), change and lagged correlations are used to analyze the nature of the relations. These correlations help empirically to interpret the time priorities among the variables. For example, if technological efficiency is an adequate causal variable, it should (among other criteria) occur prior in time to the dependent variables, and any changes in technological efficiency should be associated with changes in the other variables.

<sup>14</sup> The ID was presented by Otis D. Duncan and Beverly Duncan, "Residential Distribution and Occupational Stratification," *American Journal of Sociology*, Vol. 60 (March, 1955), pp. 493-503. In a previous paper on the subject (Labovitz, "Territorial Differentiation," *op. cit.*), the standard deviation was used to measure territorial differentiation. The standard deviation proved to be a much less adequate measure than the ID for at least two reasons: (1) it is unduly effected by extreme scores, which can give a very high measure of dispersion, even if most cases are closely grouped, and (2) the interpretation of the standard deviation is somewhat vague when it is not based on a normal distribution.

Year	New England	Middle Atlantic	East North Central	West North Central	South Atlantic	East South Central	West South Central	Mountain	Pacific	United States	Index of Dissimilarity
1960	75.1	71.8	67.3	56.0	49.1	43.6	64.6	60.5	68.0	63.0	6.3
1950	74.3	75.1	65.7	44.9	42.5	35.5	53.0	48.8	62.9	59.6	9.9
1940	76.1	76.8	65.5	44.3	38.8	29.4	39.8	42.7	65.3	56.5	14.0
1930	77.3	77.7	66.4	41.8	36.1	28.1	36.4	39.4	67.5	56.2	15.8
1920	75.9	75.4	60.8	34.7	31.0	22.4	29.0	36.5	62.2	51.2	18.3
1910	73.3	71.2	52.7	32.2	25.4	18.7	22.3	35.9	56.8	45.7	20.3
1900	68.6	65.2	45.2	28.5	21.4	15.0	16.2	32.3	46.4	39.7	22.8
1890	61.6	58.0	37.9	25.8	19.5	12.7	15.1	29.3	42.6	35.1	24.1
1880	52.4	50.2	27.5	18.2	14.9	8.4	12.5	21.6	36.2	28.2	23.9
1870	44.4	44.2	21.6	13.9	14.4	8.8	13.3	12.3	32.1	25.7	23.5
1860	36.6	35.4	14.1	13.4	11.5	5.9	12.3	10.1	18.4	15.8	27.2
1850	28.8	25.5	9.0	10.3	9.8	4.2	15.1	6.2	6.4	15.3	27.4
1840	19.4	18.1	3.9	3.9	7.7	2.1	23.4	---	---	10.8	31.4
1830	14.0	14.2	2.5	3.5	6.2	1.5	18.7	---	---	8.8	28.6
1820	10.5	11.3	1.2	0.0	5.5	0.8	16.2	---	---	7.2	26.2
1810	10.1	11.5	0.9	0.0	4.5	0.6	22.2	---	---	7.3	26.4
1800	8.2	10.2	0.0	---	3.4	0.0	---	---	---	6.1	26.3
1790	7.5	8.7	---	---	2.3	0.0	---	---	---	5.1	29.0

Sources 1950 Census of the Population, V. II. Characteristics of the Population U.S. Summary, Table 15; and 1960 Census of the Population, V. I. Characteristics of the Population U. S. Summary, Table 19.

\*Urban refers to places with a population of 2,500 or more.

\*\*Index of dissimilarity computed among the geographic divisions on the degree of urbanization.

Table 2. Degree of Urbanization,\* Canada and its Provinces, 1901-1961.

Province	Year						
	1961	1951	1941	1931	1921	1911	1901
Prince Edward Island	32.4	25.1	22.1	19.5	18.8	16.0	14.5
Nova Scotia	56.6	46.2	45.4	43.5	41.9	36.7	27.7
New Brunswick	49.1	32.2	30.9	31.1	31.0	26.7	23.1
Quebec	74.9	64.2	59.6	58.6	51.0	44.5	36.1
Ontario	79.2	58.5	59.9	58.7	55.6	49.5	40.3
Manitoba	65.0	46.2	41.0	42.1	39.2	39.3	24.9
Saskatchewan	43.0	30.2	21.3	20.3	16.8	16.1	6.1
Alberta	63.9	45.8	31.5	31.1	30.1	29.4	16.2
British Columbia	76.7	51.0	52.7	55.5	46.1	50.9	46.4
Canada	71.1	53.6	50.9	49.7	45.3	41.7	34.8
Index of Dissimilarity**	5.7	7.9	11.0	11.6	11.1	9.5	8.5

Source: 1961 Census of Canada, Bulletin 7.1-1, V. VII, Part 1, Table 1.

\*Urban refers to the population living in incorporated places.

\*\*Index of dissimilarity computed among the provinces on the degree of urbanization.

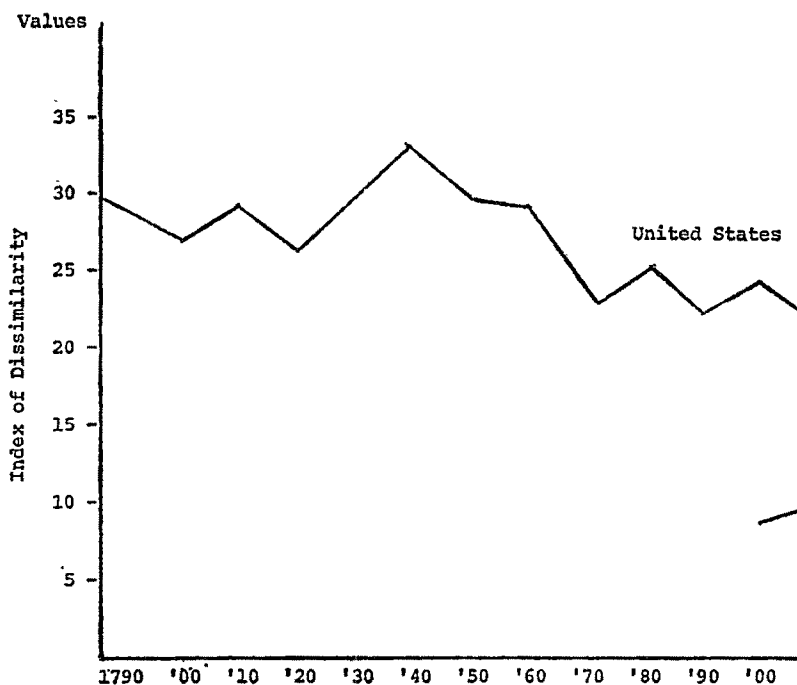
Stage III for Canada with the slight differences from 1901-1931 being but small fluctuations from the overall curvilinear pattern. The form of change derived from the theory requires a much longer period of analysis.

Note that the pattern of urban ID's for the U.S. indicates a change from Stage II to Stage III somewhere between 1840 and 1860. The shift from Stage II to Stage III represents a change from increasing to decreasing differentiations among territories. For the statistical analysis, the period from 1790-1860 is considered to be Stage II for the U.S., while Stage III is considered to be 1870-1960. Changing the cutting point to 1840 or 1850 did not appreciably alter the results of the study.

The index of dissimilarity values for all dependent variables for the U.S. and Canada are in Tables 3 and 4. The tables indicate the source for each variable and the number of census years involved. Tests of *Hypotheses II* and *III* are based on the values in these tables.

In its general form, *Hypothesis II* states that changes in technological efficiency, as measured by urbanization, lead to changes in territorial differentiation on other variables. There are two testable corollaries to this hypothesis: (A) in Stage II (for the U.S., 1790-1860), urbanization is directly related to territorial differentiation, and (B) in Stage III (for the U.S., 1870-1960, and for Canada, 1901-1961) it is inversely related to

Figure 2. Values of the Index of Dissimilarity for Divisions of the United States, 1790-1960 Provinces of Canada, 1901-1961.\*\*



\*Data from Table 1.

\*\*Data from Table 2.

Table 3. Measures of the Index of Dissimilarity\* for Selected Variables, the United States\*\*

Year	Sex Ratio <sup>a</sup>	Negro <sup>b</sup>	Fertility <sup>c</sup>	Age Dependency <sup>d</sup>	Working Females <sup>e</sup>	Primary Industry <sup>f</sup>	Secondary Industry <sup>g</sup>
1960	.9	29.2	3.1	2.7	2.3	26.9	12.4
1950	.7	36.7	3.9	4.1	4.3	28.1	17.4
1940	.9	45.3	7.7	5.6	6.7	28.6	18.1
1930	1.2	47.9	7.7	5.1	6.1	27.9	14.1
1920	1.5	53.9	5.9	5.5	7.7	26.0	16.6
1910	2.0	57.0	8.7	7.0	9.5	23.7	19.3
1900	2.0	57.4	8.9	6.7	10.7	20.5	21.5
1890	2.9	58.5	8.9	5.7	10.7	17.3	20.3
1880	3.3	57.5	8.0	6.8	14.0	15.9	24.1
1870	2.9	58.7	6.9	6.1	15.1	14.7	23.9
1860	2.7	56.8	7.3	5.1	---	---	---
1850	1.9	53.4	8.0	6.1	---	---	---
1840	1.7	51.1	9.1	---	---	---	---
1830	1.3	48.5	8.7	---	---	---	---
1820	2.1	46.7	---	---	---	---	---
1810	1.3	44.3	---	---	---	---	---
1800	1.6	42.7	---	---	---	---	---
1790	1.4	41.8	---	---	---	---	---

Year	Tertiary Industry <sup>h</sup>	Income <sup>i</sup>	Married Females <sup>j</sup>	Voting Behavior <sup>k</sup>	Education <sup>l</sup>	Establishment Size <sup>m</sup>	Value Added <sup>n</sup>
1960	2.4	7.4	0.9	2.2	2.3	7.7	4.5
1950	3.3	8.5	1.2	2.8 <sup>p</sup>	2.2	11.3	4.5
1940	4.6	13.1	1.7	4.9	1.7	11.9	5.5
1930	7.5	14.7	1.7	5.3 <sup>p</sup>	1.9	10.5	5.7
1920	6.1	13.1	1.7	11.1 <sup>p</sup>	2.3	11.9	3.8
1910	8.9	NA <sup>o</sup>	1.9	7.3	2.7	10.9	5.5
1900	10.1	15.4	2.1	5.5	3.9	9.5	6.1
1890	8.3	NA <sup>o</sup>	2.9	6.2 <sup>p</sup>	---	---	---
1880	11.7	16.5	---	---	---	---	---
1870	11.3	---	---	---	---	---	---

Sources: The values are derived from data in the following: U.S. Census of Population; Statistical Abstract of the United States; Census of Manufactures; Historical Statistics of the United States; Colonial Fires to 1957, Washington, D.C.: Government Printing Office, 1960; Harvey S. Perloff, et al., Regions, Resources, and Economic Growth, Baltimore: The Johns Hopkins Press, 1960; Everett S. Lee, et al., Population Redistribution and Economic Growth: U.S., 1870-1950, Philadelphia: American Philosophical Society, 1957. C. F. Schwartz and R. F. Graham, Personal Income by States Since 1929, Washington, D.C.: Government Printing Office, 1956.

the predicted direction. Note that the degree of urbanization for the country as a whole is correlated with the urban index of dissimilarity, which measures differences among the country's territorial divisions. In Stage II, as overall urbanization increases, the theory predicts that the territorial units become increasingly dissimilar. The sex ratio also is positively related to urbanization in this stage, as is the distribution of the Negro population. That is, both the sex ratio and per cent Negro are be-

## Notes to Table 3

\*See text for a description and interpretation of the index of dissimilarity.

\*\*Number of census years vary due to availability and comparability of data.

<sup>a</sup>Number of males per 100 females.

<sup>b</sup>Percentage of the population Negro.

<sup>c</sup>Fertility ratio: number of children 0-5 per 1,000 women 20-44.

<sup>d</sup>Number of people aged 0-14 and 65 and over per 1,000 aged 14-65. For 1850 and 1860 it is based on the population 0-14 and 60 and over.

<sup>e</sup>Before the 1940 census, this refers to the percentage of females gainfully employed, aged 10 and over; since the 1940 census, it is the percentage of females, aged 14 and over, in the labor force.

<sup>f</sup>Percentage of the working population in agriculture, forestry, mining and fishing.

<sup>g</sup>Percentage of the working population in manufacturing.

<sup>h</sup>Percentage of the working population in services.

<sup>i</sup>Personal income per capita in constant dollars.

<sup>j</sup>Percentage of females married, aged 15 and over.

<sup>k</sup>Percentage Democratic of all votes in presidential elections.

<sup>l</sup>Percentage of children aged 5-19 enrolled in public primary and secondary schools.

<sup>m</sup>Number of workers per establishment, which includes both administrative and production workers. Census year equivalents are 1958, 1950, 1939, 1929, 1919, 1909, and 1899.

<sup>n</sup>Value added (price minus cost) by manufacture per worker. Census year equivalents are 1958, 1950, 1939, 1929, 1919, 1909, and 1899.

<sup>o</sup>Not available.

<sup>p</sup>For the elections of 1952, 1932, 1912, 1892.

coming increasingly differentiated among the nine regions in this period.

In Stage III, *Corollary B* anticipates negative relations between urbanization for the total society and the ID values among the dependent variables. Lending strong support, 14 out of 15 *rhos* are negative, and the relationships are substantial in all cases, *e.g.*, seven are above .90. It is predicted that urbanization is negatively associated with urban differences among territorial units. This is supported by a *rho* of -.98. In Stage II a positive relation was predicted and supported by a *rho* of .33. The only relation not in the anticipated direction for the United States in Stage III is between urbanization and primary industry which are directly related.

It is assumed that Canada is in Stage III for the entire period under consideration, *i.e.*, 1901-1961. Although there is a slight curvilinear pattern for the urban ID in this period, the differences in ID values from 1901-1931 are so slight that they hardly give an adequate diverging pattern. Consequently, these values can be interpreted (with caution) as

Table 4. Measures of the Index of Dissimilarity\* for

Year	Sex Ratio <sup>a</sup>	Fertility <sup>b</sup>	Age Depend- ency <sup>c</sup>	Working Females <sup>d</sup>	Primary Industry <sup>e</sup>	Secondary Industry
1961	.9	2.7	1.9	4.9	19.1	14.2
1951	1.3	4.9	3.8	5.1	19.2	13.4
1941	1.9	7.4	5.4	6.2	16.5	16.5
1931	3.0	8.6	6.2	6.2	16.0	16.5
1921	3.4	8.8	6.4	6.3	13.7	17.6
1911	6.0	9.7	8.4	6.6	10.3	17.1
1901	2.9	10.3	6.4	4.8	5.5	---

Sources: Census of Canada; Canada Year Book; M. C. Ur Statistics of Canada, Cambridge University Press, 1965; Man

\*See text for a description and interpretation of the

<sup>a</sup>Number of males per 100 females.

<sup>b</sup>Fertility ratio: number of children 0-5 per 1,000 wom

<sup>c</sup>Number of people aged 0-14 and 65 and over per 1,000

<sup>d</sup>Before the 1951 census, this refers to the percentage since the 1951 census, it is the percentage of females in t

<sup>e</sup>Percentage of the working population in agriculture,

<sup>f</sup>Percentage of the working population in manufacturing

<sup>g</sup>Percentage of the working population in services.

<sup>h</sup>Percentage of females married, aged 15 and over.

<sup>i</sup>Percentage of children aged 5-19 enrolled in public,

<sup>j</sup>Number of workers per establishment.

<sup>k</sup>Value added (price minus cost) by manufacture per wor

Table 5. Relationships\* ( $\rho$ ) Between the Degree of Societal Change, and Measures of the Index Selected Variables, the United States and C

United States			
Stage II (1790-1860)		Stage III (1870-1960)	
<u>Index of</u> <u>Dissimilarity</u>	<u>Urbanization</u>	<u>Index of</u> <u>Dissimilarity</u>	<u>Urbanizatio</u>
Urban	.21	Urban	-.98
Sex ratio	.47	Age dependency	-.78
Negro	.98	Working females	-.99
		Sex ratio	-.94
		Fertility	-.59
		Married females	-.93
		Primary industry	.92
		Secondary industry	-.88
		Tertiary industry	-.94
		Education	-.74
		Establishment size	-.03
		Value added	-.48
		Income	-.89
		Negro	-.99
		Voting behavior	-.79

\*Relationships are based on the data in Tables 1, 2, 3,

\*\*See text for a description of the stages.

representing chance fluctuations from the converging pattern in Stage III. Assuming this period to be Stage III for Canada, *Corollary B of Hypothesis II* predicts that the dependent variables are negatively related to

Table 6. Relationships\* ( $\rho$ ) Between the Degree of and Selected Variables, The United States a

Index of Dissimilarity	Urban Index		
	United States		
	Direct <sup>a</sup>	Amount of Change <sup>b</sup>	Ten Ye Lag <sup>c</sup>
Education	.62	-.79	.58
Married females	.95	.02	.95
Fertility	.62	.53	.52
Sex ratio	.33	-.02	.53
Age dependency	.58	.49	.53
Working females	.97	.83	.95
Primary industry	-.89	.65	-.89
Secondary industry	.90	.62	.82
Tertiary industry	.98	.42	.88
Establishment size	.05	.81	.12
Value added	.52	-.09	.43
Income	.94	.41	.94
Negro	.10	.36	.25
Voting behavior	.76	.39	.83

\*The  $\rho$  values are based on the data in Tables 1,

<sup>a</sup>Direct  $\rho$  relations based on the urban ID and the each variable, i.e.  $P_{xy}$ .

<sup>b</sup>The urban ID is associated with the subsequent years later, i.e.,  $P_{iY_{i+10}}$ .

<sup>c</sup>The difference values between two successive cens each variable, i.e.,  $P_{i-jY_{i-j}}$ .

urbanization for the total population. Overall, the *rhos* in Table 5 support the hypothesis, since eight out of the twelve relations are in the predicted negative direction. However, four variables, establishment size, value added, married females and primary industry, show strong positive relations to urbanization.

Considering the results for both the U.S. and Canada, *Corollaries A* and *B* of *Hypothesis II* are strongly supported. Out of thirty predictions, 25 are in the direction anticipated by the theory and most are of substantial magnitude.

According to *Hypothesis III*, territorial differences in technological efficiency, as measured by differences in urbanization, are directly related to territorial differences on other social, demographic, and economic variables. To test the hypothesis, three kinds of relationships are reported in Table 6, direct, change, and lagged *rhos*.

For the U.S., *Hypothesis III* receives strong support for each of the three types of relations. The direct *rhos* are all in the predicted positive direction with the exception of primary industry. There are only three exceptions to the change *rhos*, education, the sex ratio and value added, while for the lagged *rhos* the only exception to the pattern is again primary industry. In all, 37 out of 42 relations are in the direction anticipated by the third hypothesis.

With regard to Canada, *Hypothesis III* also receives strong support from the relations in Table 6. There are four exceptions to the relations for the direct *rhos* (education, primary industry, establishment size and value added), three exceptions for the change *rhos* (education, the sex ratio, and establishment size), and only two for the lagged *rhos* (secondary industry and value added). In all 24 out of the 33 relations are in the predicted direction.

Therefore, *Hypothesis III* is strongly supported by the relations exhibited by both Canada and the U.S. Out of 75 *rhos*, 61 are in the predicted direction. With regard to the magnitude of the relations, most are substantial, although there are a few below .20.

## V

### Discussion

ALTHOUGH THE STUDY overwhelmingly supports the theory, there are a few negative cases worth exploring. Most flagrant is primary industry which does not change in the directions predicted by *Hypotheses II* and *III*. Territorial differentiation on primary industry varies inversely with urban territorial differentiation, and varies directly with the degree of

urbanization for the society. That is, as regions become increasingly alike on most characteristics, they become more unlike on primary industry. With regard to the U.S., the percentage of the labor force engaged in primary industry activities has decreased substantially in all regions; yet the rate of decrease has not been uniform for each region. Note that changes in both secondary and tertiary industries are predicted by the theory. It was noted earlier that industry specialization may act as a counterbalancing force to changes in technological efficiency, and therefore, may reduce the predictive power of the theory. Although interpreting after the fact, it appears that territorial specialization in primary industry may be the only counter-acting industry force.<sup>15</sup>

Tables 5 and 6 show that four other variables, education, value added, married females and establishment size do not always follow the predicted patterns. Two of the variables, value added and establishment size are economically based and suggest, along with primary industry, that industry structure is a crucial variable that should be taken into account in future inquiry. Education and females married follow the predicted pattern in general, in both countries, but deviate more in Canada.

In fact, although the theory is supported by the analysis of both countries, the predictions are more often in the anticipated direction and are of greater magnitude for changes in the U.S. Perhaps this can be explained by the fact that data on the U.S. were obtained for a much longer period of time, and that test of the theory requires an extensive time period. Data over a longer period of time for Canada and other countries would help clarify this assertion. Another possible reason for the theory's greater predictive power for changes in the U.S. is the type of units analyzed. For the U.S., nine geographic regions are used, which have some historical basis for the states they encompass. Perhaps the provinces of Canada have fewer historical connections, which makes the areas less homogenous internally than the regions of the U.S. Finally, the provinces of Canada are political units, while the regions of the U.S. are not. Being political units, perhaps more planned changes occur than would be anticipated by the theory.

Besides the time span, there are at least two other time factors to consider. First, although equal time periods are considered (ten years), this span is too long for anything more than gross comparisons. For example,

<sup>15</sup> It may be argued that primary activities are the most likely ones to be territorially based, because they appear to be more dependent on natural resources and geographic conditions than secondary or tertiary activities. That is, fishing is tied to oceans and rivers, agriculture to arable land, and mining to certain mineral deposits.

technological changes that occur in one year may bring about other changes in the following year. But analyzing the relationships ten years later may completely mask the causal direction and may reduce the magnitude of the correlations.

A second factor to consider in a change analysis is the comparability in definition of both the variables and territorial units from one observation period to the next. For adequate comparisons both should remain stable in each decennial census. Although the variables and territorial units used in the study appear to be reasonably stable for general comparisons, undoubtedly the degree of reliability is unknown.

With these limitations in mind, two statistical techniques were used to ascertain time priorities among the independent and dependent variables, *i.e.*, change and lagged correlations. Interpretation of the lagged correlations is hampered by the long interval between observations. If the correct causal variable and interval span are used, lagged correlations should be higher than the direct correlations.<sup>18</sup> Although this is the case for a few of the relations, in general it does not hold. However, most of the correlations are in the predicted direction. Perhaps a shorter time span would increase predictions, but equally likely the theory may require some revision.

Change analysis is a technique devised to obtain "true" rather than "spurious" correlations. A high correlation between two variables over time may be caused by the whole system moving together. Changes in values, it is argued, eliminate the rest of the system from the correlation. The results in Table 6 are in the predicted direction and, therefore, the change analysis lends further support to the theory.

Aside from the time series analysis performed separately on the U.S. and Canada, a few limited cross-cultural comparisons can be made between the two countries. Since the number of cases is only two, comparisons have been limited to inspection of 1960 values for the U.S. and 1961 values for Canada. The degree of urbanization for Canada at this time is 71.1, while for the U.S. it is 63.0. However, due to differences in the urban definition, these values are much closer than indicated. The definition for the U.S. includes all people residing in cities 2,500 or more, while for Canada the definition includes all people in incorporated places, some of which are less than 2,500. If the new urban definition now employed by the U.S. Bureau of the Census is used, the U.S. urban population is 69.9 per cent. Therefore, given certain errors in definition, observation

<sup>18</sup> Donald C. Pelz and Frank M. Andrews, "Detecting Causal Priorities in Panel Study Data," *American Sociological Review*, Vol. 29 (December, 1964), pp. 836-48.

and recording, it is difficult to say which country has the higher urban percentage. However, it is reasonable to state that they are very close. Since they are so close on per cent urban, the theory would predict that their respective ID values would also be similar.<sup>17</sup> Out of twelve variables, eleven show very similar values—these are the ID's for urban, age dependency, the sex ratio, working females, fertility, education, secondary industry, tertiary industry, establishment size, value added and married females. In seven of these comparisons, the differences are less than one per cent, *i.e.*, urban, age dependency, the sex ratio, fertility, education, tertiary industry and value added. Only primary industry exhibits substantially different values. Again the data suggest that industry structure with regard to primary activities does not conform to the theory. On the other hand, these limited cross-cultural comparisons, in the majority of cases, support the implications of *Hypotheses I and II*.<sup>18</sup>

Further tests of the theory should be made on both longitudinal and cross-cultural bases. That is, not only should more countries be analyzed over time, but several countries should be compared at one point in time. The longitudinal test is closer to the dictates of the theory, but cross-cultural comparisons should clarify certain aspects of the hypotheses. These tests are all the more important, because of the lack of adequate data over time for most countries.

With regard to the theory itself, more work and tests are needed on the effects of industry specialization, the empirical dividing point between Stages II and III, and the conditional nature of the theory. For example, the theory may have predictive power for developed countries like the U.S. and Canada (which developed first with labor intensive techniques and slowly adopted those of a more capital intensive nature), but it may not be able to predict changes in underdeveloped and developing countries that have an initial high degree of capital intensive techniques in their industrial sectors.

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<sup>17</sup> See Tables 1, 2, 3, and 4.

<sup>18</sup> Throughout the analysis, Canada and the U.S. have been treated separately, with no attention given to the obvious interdependence between the two countries. A fairly extensive industrial division of labor exists between them, which is reflected in a complex set of trade relations. Perhaps a fruitful line of inquiry is to treat Canada and the U.S. as one interdependent unit and evaluate the hypotheses presented in the paper.

### ***Child Education: A New Theory***

AMERICA FACES A REVOLUTION in education based on the discovery that the most important learning in life takes place in infancy and early childhood—before formal schooling usually begins.

This is the central point of a report, *Revolution in Learning: The Years From Birth to Six*, by Maya Pines, published by Harper & Row and supported by a grant from Carnegie Corporation of New York.

One of the most interesting new methods for teaching preschool children from backgrounds of extreme poverty and slums is being tried out at the University of Illinois, Maya Pines reports. There two professors, Carl Bereiter and Siegfried Engelmann, are trying experimental classes that feature highly structured learning, much of it by rote, as small groups of children with high-pitched, excited voices repeat sentences designed to implant fundamental processes of reasoning and the ability to put thoughts into words. Miss Pines describes the classroom atmosphere as being something like an "intellectual pressure cooker" but she cites impressive results in raising intelligence test scores of four- and five-year-old children from deprived backgrounds and fitting them to continue developing when they reach regular school age. Similar methods used with middle-class children seemed to raise their performance beyond normally expected levels, Miss Pines reports.

In the United States, Maya Pines finds the lack of adequate day care facilities for children of working mothers the single most urgent problem of our preschool children today. She notes that "Four million American preschoolers now have mothers who work. Yet only 225,000 children of all ages can be squeezed into the nation's licensed day-care facilities." She calls for massive expansion of day-care centers (which are widespread in Russia, Israel and other countries) and providing them with staff and programs that will promote the intellectual development of children.

Maya Pines' report discusses the theories and experiments of leading investigators such as Bruner and Piaget and the Russian, Lev Vygotsky, and contains first-hand descriptions of and developments in preschool education including the "talking typewriter," the Initial-Teaching Alphabet, the revived vogue for Montessori schools, new theories of linguistics and reading, and the Head Start experiments, as well as news of new programs of early education in various parts of the world. Miss Pines has written extensively in the fields of education and science. [From Stuart Harris for Harper & Row, Publishers.]

# Estate Multiplier Estimates of Personal Wealth:

## *Their Use and Limitation*

By RICHARD E. FRENCH

### I

THE PIONEERING WORK in wealth estimation began in the United States as a result of an act of Congress dated February 22, 1892.<sup>1</sup> The inquiry into the concentration of wealth was the result of growing concern over the development of industrial trusts and monopolies such as the Standard Oil Trust. Also, wholesale prices had declined throughout the latter part of the 19th century, following the Civil War. Persons enjoying fixed incomes stood to profit from falling prices while those with fixed debts stood to lose from the secular decline of prices. The concern of those originally investigating wealth and income distributions was basically social in nature:

The first estimate of wealth and its distribution in the United States was made by G. K. Holmes in 1893.<sup>2</sup> Holmes' estimates were based on the 1890 census data on families. The 12.5 million United States families and their wealth were divided into six categories. Unfortunately, Holmes estimated only tangible wealth.

The six categories into which Holmes classified families included (1) farm-hiring families, (2) families with mortgaged farms, (3) families owning free farms, (4) non-farm hiring families, (5) non-farm families owning free homes, and (6) non-farm families with mortgaged homes. Using farm and non-farm proprietorship data, Holmes allocated the 12.5 million families from the census data to these categories:

The average value of the possession of the farm and non-farm families, assumptions as to the number of farms and of families occupying non-farm houses, and arbitrary allowances for "other" possessions and debts of each class of family . . . was accomplished by a complicated procedure. . . .<sup>3</sup>

<sup>1</sup> C. L. Merwin, Jr., "American Studies of the Distribution of Wealth and Income by Size," *Studies in Income and Wealth*, Vol. III (New York: National Bureau of Economic Research, 1939), p. 17.

<sup>2</sup> G. K. Holmes, "The Concentration of Wealth," *Political Science Quarterly*, Vol. III (1893), pp. 589-600.

<sup>3</sup> C. L. Merwin, Jr., *op. cit.*, pp. 5-6.

Holmes estimated that 91 per cent of the 12.5 million families owned about \$17.4 billion of the nation's wealth. The value of the tangible wealth estimated in the 1890 census was about \$60 billion according to Holmes' data. He then concluded that the lower 91 per cent of the families owned 29 per cent of the nation's wealth and that the top 9 per cent of the families own 71 per cent of the total wealth. Holmes then concentrated on the top wealthholders. Using the *New York Tribune's* estimate of 4,047 millionaires in the United States, Holmes figured this group's total wealth to be about 20 per cent of the total national wealth by assuming each to have on the average about \$3 million. This group represented only 0.03 per cent of the total number of families in the United States. Thus Holmes concluded that in 1890, the top 0.03 per cent of families owned 20 per cent of the total wealth; the following 8.97 per cent owned 51 per cent; and the lower 91 per cent of the families owned 29 per cent of the total wealth. Although Merwin did not discuss all of the assumptions used by Holmes to derive his estimates, he did point out that Holmes' estimates involved only tangible property.<sup>4</sup>

The second estimate of wealth and its distribution in the United States was made by C. B. Spahr in 1896.<sup>5</sup> This study was statistically more pretentious than was Holmes'. Spahr based his analysis on estate data obtained from 36 counties of New York State.

Spahr divided his findings from the probated records into three groups: under \$5,000; \$5,000 to \$50,000; and \$50,000 of wealth and over. He divided the total wealth into two categories, real estate and personal property. He then increased the value of real estate in the under \$5,000 class by 50 per cent, "to allow for the many small rural estate holdings not recorded in rural counties." Next he reduced the value of personal property by 5 per cent, because in the under \$5,000 class he believed "small estates are eaten up to pay debts." He went further and divided the under \$5,000 class into \$500-\$5,000 and under \$500 wealth classes. Using the data he obtained from the 36 counties in New York State and allowing for the adjustments to the data pointed out above, he inferred the distribution of wealth for the United States for 1896.

The third individual to investigate the distribution of wealth was W. I. King, in 1915.<sup>6</sup> King used the Massachusetts records of probated estates

<sup>4</sup> *Ibid.*

<sup>5</sup> C. B. Spahr, *The Present Distribution of Wealth in the United States* (New York: Crowell, 1896).

<sup>6</sup> W. I. King, "Wealth Distribution in the Continental United States at the Close of 1921," "cited" by C. L. Merwin in *Studies in Income and Wealth*, Vol. III (New York: National Bureau of Economic Research, 1939), p. 11.

as his basic source of data. The estates were classified as to ownership by males or females. However, 40 per cent of the probated estates had no asset inventory. He assumed that the non-inventoried estates had the same size and distribution as the inventoried estates. The result was not an estimation of the amount of wealth of the living but rather a percentage distribution of the wealth of the decedents. He assumed that the size distribution of the wealth of the living was similar to the size distribution of the wealth of the decedents.

King made a second estimate of wealth some 20 years later. During the intervening years he conceded to critics that the distribution of wealth among decedents is not indicative of the distribution of wealth of the living wealth-holders. In the second study King used probated estate data secured from 20 counties in 12 widely scattered states and the District of Columbia for the period 1912-23. King's manuscript in which his second estimates are constructed was never published. However, Merwin read the manuscript which is on file with the National Bureau and reconstructed the procedure King had used to make his estimates.<sup>7</sup>

King's approach was to distribute farm wealth of \$46.5 billion, obtained from the 1922 census estimates, among all farm owners and tenants in proportion to farm size. The non-farm wealth of \$234.7 billion was distributed among non-farm residents in the same proportion that income payments flowed to them from rent, interest, and dividends, based on data taken from *Statistics of Income*.

The next investigation of the distribution of wealth was by R. R. Doane in 1935.<sup>8</sup> Doane worked with the assumption that the real property of an individual is some multiple of his tax payments. His method of moving from assessed valuation to "real" value has been severely criticized. He attempted to estimate the distribution of securities by income group by capitalizing the income from individual securities. As a result of the methods he chose to use, his estimates appear to be much too large.

Doane used as his basic data probated estates previously analyzed by others and tax information from state and federal publications. His interest in wealth and its distribution appears to have been motivated by a desire to show that the inequality in the distribution of wealth had been decreasing since the 1880's.<sup>9</sup>

<sup>7</sup> King's procedure was considerably more complex than is suggested here. Yet the general approach followed the steps listed. In fact King tried three procedures before he was able to allocate all of the adjusted wealth found in the 1922 census.

<sup>8</sup> R. R. Doane, "Summary of the Evidence on National Wealth and Its Increasing Diffusion," *Annalist* (July 26, 1935), pp. 115-18.

<sup>9</sup> C. L. Merwin, *op. cit.*, p. 20.

Doane constructed his distribution of wealth by income class. He began by distributing total tax payments to eight income classes above \$5,000, and to one class of \$5,000 and below. Next, the amount of real property estimated in the census was distributed to these income classes by assuming an average tax bill per unit of assessed valuation and relating assessed values to market values. In order to allocate intangible property, he relied on data from *Statistics of Income*. He allocated to the various income classes tax exempt securities, other bonds, notes and mortgages, stocks, savings deposits, and life insurance, by capitalizing the income flow from these assets to the various income classes obtained from income tax data. He then constructed a distribution of percentages of the total wealth held by each income group.

Doane's distribution resolves itself into a distribution of wealth arranged in the proportions in which income is distributed, which is in turn made to follow the distribution of tax payments. Precisely what meaning such a distribution has is hazardous to predict.<sup>10</sup>

A more statistically sophisticated attempt to estimate a wealth distribution by capitalizing income was made by Fritz Lehmann in the late 1930's.<sup>11</sup> Lehmann used estate tax data published in *Statistics of Income* to obtain the average value of each estate class. He then associated the average value of each estate class with stock holdings in corporations found in each estate class. From federal income tax data, the number of persons filing returns, the total reported income, and total dividend income, he estimated the amount of wealth for four income groups reporting more than \$5,000 on their 1930 federal income tax returns. By capitalizing income from stocks at an average yield of 5 per cent he determined the amount of wealth held in the form of securities for each of the four income groups. Lehmann computed the per cent of each estate class held in the form of securities and was then able to estimate the total wealth of the four income groups under observation. Lehmann's method, however, provided wealth estimates by income classes and not by wealth classes. The problem of moving from income class to wealth class remained unsolved.<sup>12</sup>

The estate multiplier method was first used by Bernard Mallet in 1908

<sup>10</sup> R. H. Jackson, "Full Text of Memorandum on National Wealth and Its Distribution" *Annalist*, (August 30, 1935), p. 292.

<sup>11</sup> Fritz Lehmann, "The Distribution of Wealth," in *Political and Economic Democracy*, Max Ascoli and Fritz Lehmann, eds., (New York: Norton, 1937).

<sup>12</sup> For a discussion of the advantages and disadvantages of Lehmann's method and of the method of capitalizing income generally, see *Studies in Income and Wealth*, Vol. III (National Bureau of Economic Research, 1939), pp. 97-146.

to estimate wealth in England, and by Laughton to estimate wealth in Australia for 1911-12.<sup>13</sup> It appears that the first estate multiplier estimate of wealth in the United States was made by Horst Mendershausen.<sup>14</sup> Mendershausen made an estimate for each of the years 1922, 1924, 1941, 1944, and 1946. His original estimates were made possible by estate data provided by the United States Internal Revenue Service.<sup>15</sup> Mendershausen's estimates of wealth were by type of asset for the top wealth-holders; because his estimates included assets by type, he was able to isolate life insurance and adjust for the difference between the reported face values and the cash surrender value of insurance at a moment before death.

Robert Lampman estimated the wealth of top wealth-holders for 1953.<sup>16</sup> Lampman also used a special tabulation of estate tax returns provided by the United States Internal Revenue Service. Using adjusted mortality rates for both White males and White females, he was able further to refine his estimates. He provided estimates of wealth of the top wealth-holders by age, sex, type of asset, and by size of wealth class. Following the procedure of Mendershausen, Lampman isolated life insurance and reduced the face value of insurance to equity value before applying a multiplier to this asset. Lampman was the first to relate estimates of wealth to the framework of the national balance sheets as developed by Goldsmith.

The third successful estate multiplier estimate of United States wealth was made by James Smith for 1958.<sup>17</sup> Following the method used by both Mendershausen and Lampman, Smith made an estate multiplier estimate of the wealth of the top wealth-holders by age, sex, and type of asset.<sup>18</sup> He related his wealth estimates to the national balance sheets as Lampman had done and went one step further by estimating the flow of income to each of the wealth classes above \$60,000.

<sup>13</sup> J. D. Smith, and Stanton Calvert, "Estimating the Wealth of Top Wealth-Holders from Estate Tax Returns," *Proceeding of Business and Economics Statistics Section*, American Statistical Association, (September, 1965).

<sup>14</sup> *Ibid.*

<sup>15</sup> *Ibid.*

<sup>16</sup> R. J. Lampman, *The Share of Top Wealth-Holders in National Wealth, 1922-56* (Princeton, N. J.: Princeton University Press, 1962).

<sup>17</sup> A special tabulation of estate tax data was provided by the Internal Revenue Service for Jeanette Fitzwilliams and Raymond W. Goldsmith, who in turn made the data available to Smith.

<sup>18</sup> J. D. Smith, "The Income and Wealth of Top Wealth-Holders in the United States 1958." (Unpublished Ph.D. dissertation, Dept. of Economics, University of Oklahoma, 1966).

The Survey Research Center of the University of Michigan and the Board of Governors of the Federal Reserve System have both been involved in recent estimates of the financial characteristics of individuals in the economy. Both have adopted sampling techniques through which they have been estimating the income, savings, debt and wealth of individuals by size distribution. Prior to 1961, the results of the Center were published in the Federal Reserve Bulletin. Since 1961, the findings have been published in the Center's own publication: *Survey of Consumer Finances*.<sup>19</sup>

In 1966, the Federal Reserve Board published the results of its most recent study of wealth.<sup>20</sup> The survey was conducted in the Spring of 1963, by using census interviewers and a special sample design developed by the United States Bureau of the Census. The survey covered the income, debts, and wealth of 2,557 consumers as of December 31, 1962. The sample included differential sampling rates:

Of the 2,557 consumer units covered in the Survey . . . interviews were completed with 532 units with wealth of \$100,000 or more and 245 of these had \$500,000 or more in wealth. As a result, the Survey supplies data not hitherto available about the size and composition of wealth of the upper income and wealth groups.<sup>21</sup>

The project was conducted under the direction and guidance of Dorothy S. Projector and Gertrude S. Weiss. Although the sample was designed to "refine" the estimates for the upper income and wealthholders, the study does provide a size distribution of wealth by using nine wealth classes beginning with a \$1-\$999 class and ending with a \$500,000 and over class. The study deals with an analysis of the determinants of the size of wealth, the components of wealth and debt and their diffusion through the economy, and the variation in the patterns of ownership among consumers of different characteristics.

It seems obvious that emphasis on the study of wealth has been directed toward the national economy with very little if any regard given to the development of similar data for individual states. This is particularly interesting in that the major source of wealth data for many of the early studies existed at the state level. Economic research, however, reflects the current needs of society. The priorities of economic development and social change have, until recently, reflected the emphasis given to national economic problems with the implicit assumption that state and regional

<sup>19</sup> J. D. Smith, *Ibid.*, pp. 15-16.

<sup>20</sup> D. S. Projector and G. S. Weiss, *Survey of Financial Characteristics of Consumers*, (Washington, D.C.: Board of Governors of the Federal Reserve System, 1966).

<sup>21</sup> *Ibid.*, p. 1.

development would follow or be a part of the total development of the nation. During the decade of the 1960's this concept has begun to change.

It is now believed by some that many economic and social problems must be solved within the local, state and regional areas themselves. In other words the solutions to state and local problems do not depend directly upon an absolute increase of the U.S. gross national product, per capita income or employment. In fact several of the economic and social problems which must be faced by individual states may actually be magnified by the success of the national economy. In order for states to deal with these new problems it will be necessary for them systematically to collect and analyze the data relating to their respective economies and communities. The creation of a series of economic data pertaining to wealth is a movement in that direction.

## II

WEALTH IS POWER. Its existence gives rise to political, social, and economic forces. For this reason the study of wealth is of interest to all branches of the social sciences. We know relatively little about the aggregate composition and distribution of wealth. Those studies which have dealt with wealth and its distribution have been concerned primarily with upper wealth groups, those with estates over \$60,000. Consequently, we lack adequate knowledge of the wealth of people whose estates are under \$60,000. This has largely been due to a lack of reliable data concerning the estates of lower and middle wealth groups. The primary source of data for estimating the amount, composition, and size distribution of the top wealth-holders has been federal estate tax tabulations especially prepared for this type of research. However, the federal estate tax laws require that estate tax returns be filed only for those estates of \$60,000 and over. Thus, data available at the federal level of government cannot be used to estimate either the size distribution or the asset composition of the wealth of individuals with estates of less than \$60,000. Inasmuch as the top wealth-holders represent approximately 1.5 per cent of the population and hold about one-third of the total personal wealth, there remains a great deal for us to learn about the wealth of the rest of the population.

Wealth flows from income and in turn gives rise to income. If the distribution of wealth is primarily a matter of the institutions of our social, economic, and political system, then an appropriate distribution of wealth implies an appropriate institutional structure. However, if

wealth and, consequently, power are too highly concentrated, then the institutions of the system may be jeopardized.

Certain questions concerning wealth and our society come to mind. Do the institutions of capitalism inevitably tend toward greater and greater inequality? Has the distribution of wealth been increasing or decreasing, either regionally or nationally? How do people hold their wealth? Does the composition of personal wealth change as one acquires greater wealth? What factors affect the amount and composition of wealth? What effect does inflation or deflation have on wealth? How would a change in tax policy affect wealth and how many people would it affect? Because of these questions and many other similar ones, the study of wealth is of importance to everyone. It is emphasized that our knowledge of the details of personal wealth is lacking and that the implications of this lack of knowledge are many. Any addition to our knowledge of wealth can be useful—particularly for public policy formulation.

The methodology and technique most recently used to estimate wealth at the national level is the estate tax multiplier method. This methodology has also been employed recently to estimate personal wealth at the state level.<sup>22</sup> There are several states in which the estate multiplier technique can be used to estimate the amount, composition and distribution of personal wealth. Such estimates can provide valuable economic data on the numbers, characteristics, and economic behavior of wealth-holders. A study of wealth at the state level can make available such information as the number of wealth-holders by size of wealth class; the composition of wealth by size of wealth class; the age and sex composition of wealth-holders by size of wealth class; and the total amount of personal wealth held by the residents of the state.

The information obtained from a study of this type could be of use to business and state government as well as to the academic community. The data developed from a study of wealth at the state level could be used for county and regional development purposes as well as to achieve a better understanding of the state's economic and social structure.

Members of the Chamber of Commerce, retailers, wholesalers, and other commercial businessmen have shown an interest in such data for the purpose of advertising and marketing analysis. Knowledge concerning the market for consumer-durable goods could be expanded by increasing the amount of data related to the composition of wealth in any given

<sup>22</sup> R. E. French, "An Estate Multiplier Estimate of the Personal Wealth of Oklahoma Residents, 1960;" (an unpublished Ph.D. dissertation, University of Oklahoma, 1967).

marketing area. Commercial banks can use such data to determine the extent of the potential market for trust funds. By combining an analysis of wealth with an analysis of personal income businessmen could improve their estimates of the potential markets for all consumer products.

A study of wealth can be of use to state government agencies. The information obtained from a study of personal wealth can help determine what groups are likely to purchase state and municipal bonds. It could also be used to determine what groups and how many people would be directly affected by a change in a tax policy affecting dividends, inheritance, home-ownership, and other property. An analysis of wealth combined with an analysis of personal income would shed additional light on the revenue problems of the several states. If states are to continue their interest in the process of economic development it is important that they obtain information concerning the different strata of their respective economies. A study of wealth should generate data concerning the wealth characteristics of the middle and lower wealth groups as well as data concerning the upper wealth groups.

The Department of Commerce has for some time been interested in developing regional and county data. To a large extent this means a modified version of the traditional national income accounting framework adjusted for states and their local regions. The use of wealth data, however, is becoming increasingly significant. Economists both in and out of government are concerned with the possibility of developing a new key series of data for measuring economic activity.

Economic growth is not only based on what is produced each year, but is also based on the total stock of land, buildings, equipment, and inventories of each economy. It is this type of data which is yet to be developed into a new key series of statistics for economic analysis.

### III

ESTIMATES OF WEALTH made at the state level have advantages and disadvantages compared to those made at the national level. The threshold for filing state estate tax returns is usually much lower than that of the federal government. In Oklahoma, for example, returns must be filed for decedents whose estates are in excess of \$100! With such a low filing requirement, estimates of wealth could be made for the middle and lower wealth groups and a complete Lorenz curve could be constructed for the size distribution of wealth within the state. To the extent that estimates are made possible for the middle and lower wealth groups, comparisons of the economic characteristics of the different wealth groups

could be made. Such a study could reveal what the asset composition of the various wealth groups is and how that composition changes as one moves from one wealth class to another. Another important economic characteristic associated with wealth is the propensity to take risk. By studying a complete size distribution of wealth it may be possible to determine if top wealth-holders have a greater propensity for financial risk than do other wealth-holders. Such a study may help to determine what wealth groups prefer to shift their portfolios toward growth stocks and which prefer bonds and which prefer real estate.

There are several disadvantages associated with working with state rather than federal estate tax data. We have learned from the Oklahoma study, however, that most of the disadvantages can be dealt with satisfactorily. The two major disadvantages involve: first, obtaining the age at time of death of the decedents, and second, adjusting the basic data so as to allocate transfers and wealth held outside the state to the major asset categories.

The estate tax return is designed to meet the needs of those administering the tax and not those wishing to do social and economic research. Thus it is not unlikely that some data relevant to the needs of the researcher will be missing from the return. From the Oklahoma experience we found that the age of the decedent was not required to be listed on the estate tax return. Since the age of the decedent is an integral part of the methodology, we were forced to go to great length and to great expense to secure these omitted data.

Usually the assets of the estates are inventoried on the state return. There are two exceptions. In the case of transfers, all that is usually required is that the total dollar value of those transfers which are taxable be listed. And, in those cases where decedents held part of their estates outside the state of residence, only the dollar value of the gross estate held outside the state is required to be listed. Because estimates of asset composition are desired, it is necessary to convert both the dollar value of transfers and the dollar value of the gross estate held outside the state of residence into one or more of the major asset categories. The first type of adjustment is made possible by analyzing the relationships that exist between the various asset categories and total amount of transfers.

The latter type of adjustment is more complex and requires knowledge of the form in which out-of-state wealth is held. By an analysis of non-resident returns filed in Oklahoma, we were able to establish a relationship between individuals' gross estate held out-of-state and the major asset

categories. Although other adjustments will be necessary, most of them can be made with confidence.

As one would expect, there are problems and limitations associated with original research and its preliminary results. Such is the case with estimates of personal wealth derived by the use of the estate multiplier methodology.

Because estate tax returns of a one-year filing period are used to form the basis of the sample, the year of death of each decedent in the sample must be inferred. Since the authorities usually allow extensions of time if good cause can be shown, and because the law allows 15 months from the date of death before a return must be filed, death could have occurred in years other than the year inferred in the methodology. Based upon a frequency distribution of Oklahoma estate tax returns, it appears that about 80 per cent of the decedents in the sample of a one-year filing period died during the year of inferred death. Furthermore, of those whose date of death was in years other than the year of inferred death, only 20 per cent held taxable estates.

The selection of an appropriate set of mortality rates is crucial to the estate multiplier methodology. If there is a correlation between mortality rates and wealth, an unadjusted mortality rate may yield a biased estimate. If the mortality rates are too low the estimates will be overstated; if they are too high the estimates will be understated. If the sample includes only top wealth-holders there is reason to adjust the mortality rates on the basis that the rich live longer. If, however, the sample includes all wealth-holders it would be extremely difficult to know where to adjust the mortality rates since it is not possible to relate decedents to their particular set of wealth data. Moreover, mortality rates are affected by factors other than wealth. Some of the more important factors affecting mortality are assumed to be income, race, occupation, and place of residence. To adjust a set of mortality rates to reflect all these factors would be desirable but impractical.

It is unlikely that all estate tax returns will be complete. To the extent that age information is omitted from the returns and/or is impossible to obtain, it will be necessary to treat those returns separately. Regardless of how they are eventually used, they will tend to bias the estimates. The extent to which their omission or inclusion will affect the estimates will depend upon the value of the estates they represent and the difference between the unknown age and the assumed age of this unknown group. Instead of omitting this group of returns they usually are carried into the sample by assigning to them the average age representative of the deced-

dent's sex. Thus the estimated total wealth of both sexes would be adjusted to reflect the data filed for the unknown age group.

One asset included in the returns filed for decedents is uniquely different from the others. That asset is life insurance. The objective of using the estate multiplier is to estimate the wealth of living wealth-holders. However, the value of life insurance as an asset in the estate changes at the moment death occurs. In order to estimate the value of this asset at a moment before death, it is necessary to obtain the actual surrender value of the policy. Since only the amount payable is recorded in the estate tax return that value must be estimated.

The estimates of economic estate (as opposed to gross estate) can be severely limited by omitted, incomplete, or indistinguishable data concerning the debts of the estate incurred by the decedent prior to his death. This limitation is more relevant to state estate tax returns than to federal estate tax returns. The importance of debt to those executing the return is primarily a function of the value of the estate. In the case of non-taxable returns, items of debt are likely to be recorded but not inventoried or in some cases may not be recorded at all.

Where estate tax returns are not audited the possibility exists of under-reporting. This would of course affect the final estimates of wealth. The experience of both federal and state governments has been that auditing increases the total value of reported assets on estate tax returns by 7 to 10 per cent. Obviously where the returns are not audited the result will be a tendency to understate the estimates of actual wealth.

#### IV

IN SUMMARY, THEN, the estate multiplier technique can yield reliable estimates of personal wealth. It is adaptable to the data available at both the federal and state levels of government; and, it allows for those adjustments necessary to refine the data. This methodology allows one to estimate not only total personal wealth but also to estimate the size distribution and asset composition of wealth, by wealth class. This kind of wealth classification increases the uses to which these estimates can be put and thus broadens the scope of economic analysis.

The major obstacle in any attempt to estimate wealth is the availability of the required data. For estimates of wealth of top wealth-holders IRS data is sufficient. But for estimates of the wealth of the lower and middle wealth-groups, data must be obtained at the state level.

If estimates of wealth are made for those states where the data are available, another dimension to the social and economic structure of those states

will be created. This new series of data can be of considerable importance to both the business community and to the state for the purpose of economic analysis.

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### A Planner in the Presidency

FERNANDO BELAUNDE-TERRY, who was inaugurated constitutional president of Peru in 1963 and held the office until deposed by a military coup in 1968, is an architect and planner who was graduated from the University of Texas in 1935. By his development program for Peru, embracing roads, schools, hospitals and other needed public institutions and facilities, he brought hope to the mass of Peruvians. In his book,<sup>1</sup> written for the American Studies Press established by the North American anthropologist David A. Robinson, Señor Belaunde-Terry presents a manifesto for a campaign for the conquest of Peru by Peruvians, abolishing the latifundia, cultivating vast unexploited regions and re-establishing an equilibrium between man and the land to provide a secure basis for social justice and collective welfare within a democratic society.

Mr. Robinson presents one of the most comprehensive compilations of the facts about a South American country that has yet appeared.<sup>2</sup> His is a multi-discipline survey of the historical, economic, social and geographic facts bearing upon the situation of Peru. The extent of land monopoly is shown by a table summarized as follows: "Of 2,663,235 hectares of cultivated land reported in the 1961 Agricultural Census, 723,650 are reported as being held in plots of five hectares or less, while at the other extreme, four-tenths of one per cent of the deeded properties in the country control 77.7 per cent of the farm land" (p. 120). In a thought-provoking section on land reform, Mr. Robinson concludes: "The decisions that must soon be made will shape the whole course of Peruvian events, for better or worse, for generations to come" (p. 125).

<sup>1</sup> *Peru's Own Conquest*. By Fernando Belaunde-Terry. Lima, Peru: American Studies Press S.A., 1965, (P.O. Box 4217); Blaine Ethridge—Books, distributor, 13977 Penrod Street, Detroit, Mich. 48223, 219 pp., \$7.25.

<sup>2</sup> *Peru in Four Dimensions*. By David A. Robinson. Lima, Peru: American Studies Press S.A., 1964; Blaine Ethridge—Books, distributor xiv + 424 pp., bibliography, \$10.75.

# The Budget and Consumer Sovereignty

By HAROLD S. DIAMOND

## I

THE AIM of this exploratory study is to investigate consumer sovereignty in the public sector of the economy. If the consumer is to be sovereign he must control both the public and private sectors. He must dominate macroeconomizing as well as microeconomizing.

Size alone is a clear indicator of the importance of the federal budget. But much more than size is involved. This budget, for example, is described as the "key instrument in national policy making," as the means by which "the Nation chooses what areas it wishes to leave to private choice and what services it wants to provide through government," and as determining what "should be provided at the federal rather than the state or local level."<sup>1</sup>

Consumer sovereignty, as used here, is taken to mean a process of choice such that the society embodying it may be clearly seen as the result of that choice. Choice must be free, informed, responsible and personal. The immediate frame of reference for the idea of consumer sovereignty is the entire economy—public as well as private sectors—and closely associated with it are matters political and social. The whole people rather than any part thereof are to have the duty and responsibility of making these choices and accepting their consequences.

Freedom of choice is basic to this concept. Personal choice is stressed because choice must not be made for persons but by them. It was also stipulated that choice be informed and responsible. People who freely choose must live according to the consequences of their choice, they must solve their problems for themselves. And in order that the act of choice be meaningful it must be an informed choice. Uninformed citizens do not make for true consumer sovereignty. The range of information called for is great, the problem of obtaining it is a serious one. Outdated theories and assumptions must not be imposed on people whose world is being transformed before their eyes. "Ideas are news," states James Reston, "and we are not covering the news of the mind as we should."<sup>2</sup>

<sup>1</sup> *Report of the President's Commission on Budget Concepts* (Washington, D.C.: U.S. Government Printing Office, Oct. 1967), p. 11.

<sup>2</sup> James B. Reston, "The Press, the President and Foreign Policy," *Foreign Affairs*, July 1966, pp. 553, 569-70.

Consumer sovereignty at times has been associated rather exclusively with certain types of political economy. In our opinion it is wrong to put consumer sovereignty into an ideological straight jacket. Of course, it can not be part of any totalitarian system. Beyond that, however, a flexible approach to the matter is needed. Briefly put, there is no reason why consumer sovereignty has to depend almost entirely on an economic system whose main character is reflected in a free market and price system. It is not enough for consumers, and producers also, merely to respond to the signals of the price system with little knowledge of the economic totality. It is necessary that they be informed of the total picture. Consumer sovereignty means the sovereignty of the consumer in allocating resources whatever the methods used in this allocation may be—market or otherwise. Consumer sovereignty requires that major emphasis be centered on the facts of the new historical setting wherein huge amounts of resources are allocated through governmental activities.

## II

THE FEDERAL BUDGETARY PROCESS is introduced by the President's annual State of the Union Message which may be considered as an expression of his idea of the overall valuations of the nation. Soon after this message come the Budget Message and Budget itself. These represent the Chief Executive's statement of the basic goals, preferences and priorities of the nation together with suggested allocation of the means for their attainment. It is at the executive level that the most far-reaching decisions are made and presented for implementing legislation—decisions which not only allocate the nation's resources between the sectors but also stipulate how they are to be used in the public sector and how the public sector's output is to be distributed. The budget also has an additional important effect on the private sector in that it conditions much of its activities to conform with the programs and principles of the public sector.

The budget is a major challenge to consumer sovereignty. How can this executive budgetary planning and congressional lawmaking be carried on so as to represent the multitude of free persons' informed decisions, *i.e.*, a true consumer sovereignty rather than the product of minority power and control?

There is a long history of efforts by economists to deal with the problem of social preferences.<sup>3</sup> But satisfactory answers from the standpoint of

<sup>3</sup> See Richard A. Musgrave, *The Theory of Public Finance* (New York: McGraw-Hill, 1959).

consumer sovereignty have not yet been forthcoming. Further, the social as well as fiscal scope of recent federal budgets is so much greater than those of ten years ago that the differences may be regarded as not of degree but of kind. Thus the problems of consumer sovereignty have been greatly intensified.

The leading problem of consumer sovereignty is twofold: first, how to achieve a process of economizing in the public sector which embodies the preferences of freely operating and informed persons, no one being excluded from the process; second, how to maintain a true consumer sovereignty in the private sector at the same time.

It is most important that a solution in the public sector not be at the expense of the private sector. The clash of sectors may be illustrated by a few excerpts from an exchange between Dr. Paul Douglas, then Senator, and Dr. Gardner Ackley, then chairman of the Council of Economic Advisors, at a hearing on fiscal policy in July, 1965.

Senator Douglas. Let me ask what would you say to an antitrust policy of reducing prices to match purchasing power instead of trying to pump purchasing power up to the level of prices?

Mr. Ackley. I certainly am a strong supporter of antitrust policy. I think it is a major element in our economic structure, an important one which helps account for our general economic success. However, I rather doubt that antitrust policy could or should be used as a major weapon of redistributing income from corporations to individuals.

Senator Douglas. Well, if we had a competitive economic system would we have these difficulties which we are trying to remove?

Mr. Ackley. It is very difficult to imagine what a purely competitive economy would look like in the textbook sense of the term. It would be a very different economy. It would have many advantages. But perhaps it might also have some disadvantages. I think the kind of economy that our antitrust laws try to promote is not really the purely competitive economy described in textbooks.

Senator Douglas. Well, not in the sense of an infinite number of producers each producing an infinitesimal fraction of the total supply. That, of course is true. But is it not true also that the attempt to cure unemployment by fiscal means is apt to push into the background any emphasis upon antitrust policies as a means of increasing competition and getting prices reduced?

This is the way that I have always felt Keynes was generalizing and giving a false interpretation of what was happening in Great Britain. Great Britain ran for almost 15 years with high unemployment, and Keynes described various reasons which were monetary and fiscal in character.

But all the English economists disregarded the fact that right under their eyes England was becoming cartelized. . . .

Keynes assisted in cartelizing industry, and making industry less competitive. Robbins and Keynes—you never could get them to admit that monopoly or quasi-monopoly was a cause of continued unemployment, and they turned continuously to fiscal policy and monetary policy as a means of offsetting this weakness in the society about them.

And if monopoly is inevitable—if you cannot do anything about it—then I would welcome these compensatory movements. But I would want to be pretty certain that they do not push into the background efforts to introduce a greater degree of competition.

Now I wonder what your comments would be on that.

Mr. Ackley. I would merely express the hope that preoccupation with fiscal and monetary policy to maintain high employment would not divert attention from the structural problems of our economy, one of which is the problem of competition. I think the British economy today undoubtedly suffers from the stagnation of innovation, from rigidities, and from a nonprogressive structure which, at least in part, are attributable to the high degree of concentration in British industry.

Senator Douglas. I do not like to label people, but I would say the new economics has contributed to this comparative indifference to competition, and has led to anesthetizing people, so that they do not have much emotional interests in antitrust policies or antimonopoly policies, all with the best intention in the world I am sure.

Mr. Ackley. I would hope certainly that we could continue to progress both on the side of management of total demand and on the structural problems of the economy. We certainly ought to be able to keep both on the front burner at the same time.

Senator Douglas. Well, how many front burners do you have? I have only seen two thus far, fiscal policy and monetary policy, but nothing for antitrust policy.<sup>4</sup>

Significantly, this problem has also been noted by Walter Heller, who points out how difficult it is for public officials to solve microeconomic problems. Stopgaps which interfere with the free play of market forces had to be resorted to in some cases, *e.g.*, with balance of payments problems. But government policy, hopefully temporary, "has its costs in reduced efficiency, freedom of choice, and effectiveness in implanting microeconomic truths."<sup>5</sup>

<sup>4</sup> *Fiscal Policy Issues of the Coming Decade*, Hearings of Subcommittee on Fiscal Policy, Joint Economic Committee, 89th Congress, 1st Session July 20–22, 1965, p. 27.

<sup>5</sup> Walter W. Heller, *New Dimensions of Political Economy* (Cambridge, Mass.: Harvard University Press, 1966) pp. 47–48.

A leading problem of consumer sovereignty in the public sector is the process of macroeconomizing. How can a true economizing process be set up in connection with macrochoice? How can everyone's preferences be reflected in the programs proposed in the federal budget? What methods can be used to determine national priorities and national goals? How can rational allocation of resources be legislated so as to embody a balance of desires and costs so that at the margin each last dollar of expenditure on each program reflects equal benefits to all? This is an area which will require long and hard work before any way of attaining real economizing is possible. As it now stands it is disheartening to note how far we are from the desired goal.

A recent statement by the Committee for Economic Development (CED) points out some interesting aspects of the present state of affairs. It emphasizes that the Congress has the primary function of deciding major issues of public policy. Congress should make it possible for the informed will of the people to prevail through a process of open debate and compromising of divergent interests. Further, Congress should review the execution of its programs. But Congress, according to the CED, fails to debate and decide national fiscal policies in any broad comprehensive manner, while it makes excessive delegation of authority to subcommittees.<sup>6</sup> Now, it also has been claimed that it is an oversimplification to assume that a single set of national objectives can be easily identified and agreed upon. Further, it is stated that:

... in our highly diverse society broad national goals should emerge from a consensus that is hammered out of a complex of differing goals with differing emphases on the part of numerous regional, social, economic and political groups. Not only must room be permitted for voicing divergent views, but such expressions of differing views by groups having diverse interests and responsible citizens in general must be encouraged.

Differences of opinion in the formulation of national goals most often are likely to be resolved by the assignment of different priorities in their demands on what are, after all is said and done, finite resources. A listing of national goals would clearly reveal more objectives than the resources available for their simultaneous achievement. Priorities, therefore, must be determined. While the executive has a leadership function to perform in proposing priorities, Congress must assume the ultimate responsibility for establishing such priorities.<sup>7</sup>

All this is necessary if we are to move towards a real consumer sover-

<sup>6</sup> *Budgeting for National Objectives*, Committee for Economic Development (New York, January 1966), pp. 41-42.

<sup>7</sup> *Ibid.*, p. 58, memorandum by Philip Sporn.

eignty. But much more is needed if we are to achieve a macrochoice political economy. Some recent developments indicate that the problems of macrochoice, of program evaluation, etc., are being tackled by those who are involved with the budget and problems of macroeconomizing. For example, Budget Bureau director Charles L. Schultze has pointed out that two kinds of choice are involved in efficient resource allocation in the federal sector of the economy: "first, a choice of the least-cost method of carrying on a given program—in other words, cost reduction; second, choice of where to allocate budgetary resources among the many competing claims of existing and proposed new programs—we might best describe this as program evaluation."<sup>8</sup> He makes clear that this analysis must be carried on throughout the full range of governmental activities. In addition, he points out that while many measures of effectiveness of programs are already in use, much better ones are needed and are being worked at.<sup>9</sup>

A key question was put to Mr. Schultze by Senator Miller when he asked how we could evaluate the success or failure of a particular budget. The response was:<sup>10</sup>

That is a tough one, Senator. I would have to do it in two directions, I think. One would be an evaluation of the budget as it affected the overall economic prosperity, growth, price stability, everything else in the nation—the overall impact of fiscal policy. How well has this budget contributed toward our national economic goals? This is not easy, but it is much easier than the second one I am going to have to discuss in order to answer your question which goes to precisely what I have just been talking about. How well and efficiently do the individual programs on the expenditure side of the budget (a) accomplish the nation's objectives and (b) at a minimum possible cost.

Now, from the standpoint of consumer sovereignty we must object to that part of Mr. Schultze's reply which refers to the contribution of the budget to our national goals. The so-called goals can hardly be thought of as an expression of real consumer sovereignty. And as mentioned in the CED study, we could not say that our elected representatives had even formulated these goals. This gap in the present state of our real consumer sovereignty is very great.

President Johnson, in his Budget Message of January 29, 1968, noted that two years had passed during which the Planning-Programing-Budgeting (PPB) system had been in use. It made for great economies

<sup>8</sup> Hearings, *Fiscal Policy*, *supra*, p. 62.

<sup>9</sup> *Ibid.*, pp. 63–64.

<sup>10</sup> *Ibid.*, p. 70.

in government spending, an increase in the effectiveness and efficiency of government operations through comparisons of costs and benefits and the analysis of alternative ways to achieve objectives.<sup>11</sup>

Ever wider use of PPB at all levels of government is developing and greater efficiency in carrying out government programs is one of the results.<sup>12</sup> The important question about PPB in the context of this study is: What does PPB have to do with consumer sovereignty? The answer is that it has very little to do with it as of now but that it may aid or detract from it in the future.

It may detract because PPB as currently used by the executive branch of government not only analyzes costs and benefits but sets up goals and priorities. To continue in this manner would be the death of consumer sovereignty. People, in the name of efficiency, would become prisoners of bureaucratic planning. On the other hand it has been suggested that PPB will be of much value to those congressmen who will be willing to use it.<sup>13</sup> Granting this, there will still be a great gap between that use and a real consumer sovereignty. It is the people, not their representatives, who must determine the basic values and priorities of their society if real consumer sovereignty is to exist. PPB can be a great help in aiding Congress to legislate efficiently but it cannot give them the people's preferences. It has been noted that PPB is not of much help in making marginal valuations, for example William Gorham of Department of Health, Education and Welfare (HEW) stated:<sup>14</sup>

Let me hasten to point out that we have not attempted any grandiose cost-benefit analyses designed to reveal whether the total benefits from an additional million dollars spent on health programs would be higher or lower than that from an additional million spent on education or welfare. If I was ever naive enough to think this sort of analysis possible, I no longer am. The benefits of health, education, and welfare programs are diverse and often intangible. They affect different age groups and different regions of the population over different periods of time. No amount of analysis is going to tell us whether the nation benefits more from sending a slum child to preschool, providing medical care to an old man or enabling a disabled house wife to resume her normal activities. The "grand decisions"—how much health, how much education, how much welfare, and which groups in the population shall benefit—are questions

<sup>11</sup> *The Budget of the United States Government, Fiscal 1969* (Washington, D.C.: U.S. Government Printing Office, 1968), pp. 40-1.

<sup>12</sup> *The Planning-Programming-Budgeting System: Progress and Potentials*, Hearings of the Subcommittee on Economy in Government, Joint Economic Committee, 90th Congress, 1st Session September 14, 19, 20 and 21, 1967; pp. 1-2.

<sup>13</sup> *Ibid.*, p. 103.

<sup>14</sup> *Ibid.*, p. 5.

of value judgments and politics. The analyst cannot make much contribution to their resolution.

Our opinion is that judicious use of PPB by citizens and their governmental institutions could contribute much to achieving a real consumer sovereignty. The problem involved in so doing is at once most obvious and complicated: that of forming an educated citizenry sufficiently concerned to make rational use of such analyses and to demand governmental practices which respond flexibly and impartially to its preferences.

### III

THIS STUDY'S EMPHASIS on the public sector does not mean that the problems of the private sector have been solved. This sector is far from realizing a Paretian optimum in any real sense. Its departures from consumer sovereignty are many and have often been noted.<sup>15</sup> Further, as already indicated, there is an area of interaction between both private and public sectors with special problems of its own. But all these problems are beyond this brief study. We turn, therefore, to the problems of the public sector. They must be recognized and analyzed before they can be solved. Some of them fit into the following categories.

1. Clear enough is the basic problem of maximizing budgetary benefits. Solutions, even with the help of PPB, are most difficult. One method—that of imposing a solution—is of no value because it negates consumer sovereignty. Objections to interpersonal utility comparisons nullify other avenues of solution.

To further consumer sovereignty requires that government function as a means by which the people obtain a maximum of satisfaction from the public goods *they* request the government to provide, and that this be done in efficient manner. What one often observes in government at any level is that it acts so as to maximize the particular governmental unit's tenure in office.<sup>16</sup> This practice is likely to be at the expense of consumer sovereignty.

While at one level of government the aim may be to maximize tenure in office, at another, say, that of the budgeting officials, there may be no maximizing effort at all. It is claimed that these officials usually try to

<sup>15</sup> See F. Knox, "The Doctrine of Consumers' Sovereignty," *Review of Social Economy*, September, 1960, pp. 142-44; and Harry K. Girvetz, *The Evolution of Liberalism* (New York: Collier Books, 1963), ch. 8.

<sup>16</sup> A. T. Peacock, "Economic Analysis and Government Expenditure Control," in *Public Expenditure, Appraisal and Control*, ed. A. T. Peacock and D. J. Robertson (London: Oliver and Boyd), p. 3.

sector often have to become involved in multiple demand creation in order to get what some of their constituents desire in the way of public goods. To get votes for one project, a congressman may have to vote for many additional programs. Whether this be called logrolling or otherwise, the point is that this kind of multiple demand makes a mockery of consumer sovereignty and efficient resource allocation. Under it voters neither care nor know what the price of the projects they seek will really be. As for their representatives, they are quite willing to overbuy in order to maintain their position in government. In this vein it may be noted that each kind of governmental expenditure has its own clientele whose support outweighs any unorganized opposition by the general taxpaying public.<sup>25</sup> To speak of a social consensus in connection with an appropriation bill sounds like having recourse to the mystique of the "general will" claims another observer.<sup>26</sup>

There is evidence that many consumers have little realization of what is required of them by way of rational choice among alternative fiscal programs. While they are familiar with their preference functions when it comes to the use of their private funds and tend to act with some consistency in this respect, it was found that there are doubts about the fruitfulness of a corresponding concept of a preference function for alternative fiscal policies.<sup>27</sup>

The public's attitudes to government's fiscal programs show a sharp change in their desire to expand programs when increased taxes are to accompany the expansion. Table 2 illustrates this point. In 5 of the 14 categories more than 50 per cent preferred additional spending, but in no case was there 50 per cent who wanted more spending when it was to be coupled with a tax rise.<sup>28</sup> In Table 3 the data for 11 categories of Table 2 are presented and ranked in order of size of response. This shows a different ordering of preferences when additional taxes are involved, *e.g.*, Education now ranks first, Help for Older People second, Defense, Re-armament third, and so on. Thus consistency is lacking in people's preferences for program increases when they are required to evaluate them in connection with increased taxes as opposed to merely desiring an increase in a given program.

<sup>25</sup> Murray L. Weidenbaum and John S. Saloma III, *Congress and the Federal Budget* (Washington, D.C.: American Enterprise Institute for Public Policy Research, 1965), p. 6.

<sup>26</sup> V. O. Key, Jr. "The Lack of a Budgetary Theory," *American Political Science Review*, Dec. 1940, p. 1143.

<sup>27</sup> Eva Mueller, "Public Attitudes Toward Fiscal Programs," *Quarterly Journal of Economics*, May 1963, p. 223.

<sup>28</sup> *Ibid.*, pp. 215-16.

Other evidence shows that voters do not make rational calculations of costs and benefits. Further, while consumers are motivated to improve

Table 2  
ATTITUDES TOWARD GOVERNMENT PROGRAMS

Program	Government should spend					More even if taxes had to be raised <sup>2</sup> %
	More %	Less %	Same %	No Opinion %	Total %	
Help for older people	70	3	23	4	100	34
Help for needy people	60	7	28	5	100	26
Education	60	7	25	8	100	41
Slum clearance, city improvements <sup>1</sup>	55	9	24	12	100	n.a.
Hospital and medical care	54	9	28	9	100	25
Public works <sup>1</sup>	48	11	31	10	100	n.a.
Defense, rearmament <sup>2</sup>	47	6	34	13	100	30
Support for small business	37	11	31	21	100	n.a.
Highway construction	36	10	45	9	100	13
Unemployment benefits	29	14	45	12	100	10
Parks, rec- reational fac.	27	15	48	10	100	7
Space exploration <sup>2</sup>	26	32	28	14	100	14
Support for agriculture	20	26	34	20	100	6
Help to other countries <sup>2</sup>	7	53	28	12	100	2

<sup>1</sup> Question asked only in June 1961.

<sup>2</sup> Question asked only in Nov. 1961.

n.a. Not available.

SOURCE: Eva Mueller, "Public Attitudes Towards Fiscal Programs," *op. cit.*, p. 215.

their knowledge of different products in the private sector, such is not the case with respect to proposals in the public sector. Not only is rational

calculation difficult, it is not even attempted by many people, especially those in low income groups. Voters were found to act not because of their specific knowledge of costs and benefits but rather on the basis of some vague attitude.<sup>29</sup>

It also was noted that citizens found it difficult to evaluate the wisdom of major policies both foreign and domestic. They could not clearly determine what they should do. When it comes to evaluating long-term policies, it was found that this was too much for many people. Hence, they delegated the responsibility of making decisions to their representatives.<sup>30</sup>

In short, the demand schedule for many public goods does not have the same characteristics in practice which those in the private sector have.

Table 3  
GOVERNMENT PROGRAM ATTITUDES

Program	More spending	Rank	More spending, with tax rise	Rank
	%	#	%	#
Help for older people	70	1	34	2
Help for needy people	60	2.5	26	4
Education	60	2.5	41	1
Hospital and medical care	54	4	25	5
Defense, rearmament	47	5	30	3
Highway construction	36	6	13	7
Unemployment benefits	29	7	10	8
Parks, recreational fac.	27	8	7	9.5
Space exploration	26	9	14	6
Support for agriculture	20	10	7	9.5
Help to other countries	7	11	2	11

SOURCE: adapted from table 2.

In the public sector a combination of political and economic demand exists which often means that there is a multiple, conglomerate, delegated demand for public goods. This situation has the effect of placing a compulsory surcharge on the entire society which must pay in order to get these so-called public goods. It represents a power-barter system which is inefficient and strongly anti-consumer sovereignty.

3. Abuse of advertising has long been viewed both as wasteful and harmful to consumer sovereignty in the private sector of the economy. It

<sup>29</sup> William C. Birdsall, "A Study of the Demand for Public Goods," in *Essays in Fiscal Federalism*, ed. Richard A. Musgrave, (Washington, D.C.: The Brookings Institution, 1965), pp. 285, 191-93.

<sup>30</sup> Mueller, *op. cit.*, pp. 228, 235.

must be noted that greater harm may be done in the public sector through the many methods by which government is able to propagandize the public, often through omission as well as by commission. Here the advantage of the party in power is so great that it is a major roadblock to real consumer sovereignty. It calls for strict regulation, *i.e.*, a tough code of ethics which will prevent the party in power from exploiting its great advantage in unfairly influencing the people. Failure to make this part of the rules of the political game will be much more harmful to consumer sovereignty than the advertising that the consumer is exposed to from the private sector. A major difference is that the private sector may try to persuade but it cannot force, while the operations of the public sector carry with them the force of governmental compulsion.

A recent study states that the federal government spends some \$425 million per year on behalf of its own publicity. By comparison, it spends in the same period \$333 million on the combined legislative and judicial branches. It is claimed that much of this expenditure is devoted to persuading Americans that their government's activities are for their welfare. Involved in these publicity programs are some 6,853 full or part time federal employees who spend their time informing and influencing the public.<sup>31</sup>

While the above is a substantial amount in terms of direct expenditure, it should not be considered in any way as a complete measure of governmental influence. There are so many "free" means of influence that no accurate estimate of the totality seems possible.

Between the pressures from the public as well as the private sectors of the economy, fewer and fewer alternatives appear which seem available to most people, except to the very wealthy. For most consumers the outlook is one of having "no alternative to the kind of commodities, the kind of education and the kind of enjoyments that are ordered for them by foundations, legislators and functionaries."<sup>32</sup>

4. Regardless of the degree of concentration in certain industries, the consumer is involved with many firms. But in the public economy the number of governmental levels are few, the major one by far being the federal government. Further, where important monopoly does exist in the private sector, it is regulated in some way by government. But who is to regulate the government monopoly itself? Again we come to the necessity of constraint on government if a real consumer sovereignty is to prevail.

<sup>31</sup> *New York Times*, March, 19, 1967.

<sup>32</sup> John Nef, *A Search for Civilization* (Chicago: Henry Regnery, 1962), pp. 134-35.

It has been pointed out that the American fiscal structure is highly decentralized, so much so that over one half of civilian fiscal affairs are carried on at the state-local level.<sup>33</sup> This being so, it is all the more remarkable that so much power has been concentrated at the federal level. A relatively new step in federal-state relationships seems likely to strengthen rather than weaken this concentration. The step referred to is the maintenance by some 12 states and several cities of lobbyists in Washington. They vie for some \$15 billions of U. S. funds annually distributed to the states in the form of grants, contracts and other financial aid. Some states maintain fully staffed offices in the capital. In some ways these lobbyists augment their state delegations in the House and Senate.<sup>34</sup> A further step in the linking of the state governments and the national administration was recently announced. The plan, approved by the President, will put four of five states under the direct supervision of a cabinet member in order to improve relations between the White House and the states. Cabinet members so assigned will function as "diplomatic agents" between state Governors and the President.<sup>35</sup>

It has been stated that no single authority has the power to decide what will be in the federal budget.<sup>36</sup> But the President of the United States has the great advantage of submitting a budget which represents the highest concentration of planning in the nation. No other plan, if such exists, comes near the federal budget in overall importance for the entire nation. There are no competitors at this highest level. The advantage of the executive is both unique and overwhelming.

5. It is relatively easy for consumers to correct mistakes which they may have made in the allocation of their resources. In most instances experience is a swift, hard teacher. At the public level, however, this corrective is largely absent. There is little consumer knowledge and less experience with many governmental projects. When the consumer does become aware of things, he is likely to find that the objectionable programs have become so institutionalized that it is extremely difficult to get rid of them. In the private economy the consumer is linked to the producer via the profit motive. The power motive prevails in the public sector. Finally, a most telling difference, as already mentioned, is the compulsion of the public sector, and compulsion and consumer sovereignty are often in funda-

<sup>33</sup> Richard A. Musgrave, "Introduction," in *Essays in Fiscal Federalism*, ed. R. A. Musgrave (Washington, D.C.: Brookings, 1965), p. 2.

<sup>34</sup> *New York Times*, Nov. 13, 1966.

<sup>35</sup> *New York Times*, June 8, 1967.

<sup>36</sup> A. Wildavsky, *op. cit.*, p. 131.

mental opposition. The matter becomes one of legitimate versus illegitimate compulsion. Legitimate only when there is an informed citizenry able and willing to make decisions for itself through the machinery of government which it has chosen for itself to operate under.

#### IV

SOME PROBLEMS AND OBSTACLES in the way of consumer sovereignty have been identified and discussed. Solutions, however, are not always readily at hand. We can slide along as we have been doing for many years, always getting further from the goal, or we can make an about face here, there, wherever possible at any time and place, gradually accumulating these gains toward a significant change in the state of consumer sovereignty.

A number of major objectives are clearly indicated if a real consumer sovereignty is to be created.

1. Congress must change many of its practices and become more sensitive to informed public opinion. Citizens should neither be overrepresented nor underrepresented. Congress must become flexible enough to curtail and discontinue programs as they lose importance to the nation. Congress must become more creative. It should not let itself be continually dominated by the budgeting of the executive branch of government.

2. The power of the President and executive branch of government must be kept within proper limits which do not abuse that power nor use it unfairly. The Supreme Court might be given some new role in this connection.

3. A large majority of the citizens must strongly desire a real consumer sovereignty. They must consider it worth the cost and effort needed to obtain the necessary knowledge. They must participate widely in political activity, never surrendering their direct involvement, seeking instead to broaden it.

4. The ultimate requirement for a real consumer sovereignty is vast improvement in the quality of the citizens who are to create, exercise, and maintain it.

## Tax-Induced Slow Turnover of Capital, II

By MASON GAFFNEY

### II

#### Appreciating Assets

WE BEGIN with a simple "point-input point-output" model investment approximated by a tree plantation. All cost,  $C_0$ , is incurred at the beginning of year 0; all returns come at the beginning of year  $m$  (maturity). There are no intermediate explicit revenues or explicit costs, although of course there are implicit interest costs every year, and implicit site rents, and implicit income through appreciation.

In the absence of taxes investors adjust to an equilibrium so that trees of whatever maturity yield the same yearly rate of return,  $i$ . Each tree has two values: a liquidation value for immediate harvest; and an investment value for buying and holding to maturity. The investment value begins at the planting cost,  $C_0$ , and grows at the rate of interest. The liquidation value is always below the investment value except at maturity, when it catches up by virtue of faster growth. At this point both grow at the rate of interest,  $i$ ; thereafter the liquidation value would have grown slower, which is why maturity had arrived.<sup>12</sup>

Some trees mature fast, others slow, others slower yet. In pre-tax equilibrium, prices and costs all adjust so that each has an optimal maturity year when it yields  $i$  percent; that is when investors do harvest them; and this represents a normative condition in which the sovereign consumer reigns and rules.

Algebraically, the equilibrium condition is:

$$(1) \quad (1+i)^m = R_m$$

where  $R_m$  is the ratio of stumpage revenue in the year of maturity,  $m$ , to planting costs,  $C_0$ . If you prefer,  $R_m$  is revenue per dollar of cost; or it is revenue on the assumption that  $C_0 = \$1$ .

Now the state imposes an ad valorem severance or excise tax, *i.e.* it takes a fixed percentage,  $t$ , of the gross value of stumpage. The investor's rate of return after tax,  $r$ , is, of course, now reduced below  $i$ . But the reduction is not uniform. The longer the maturity, the less the reduction. Let us show that algebraically:

$$(2) \quad (1+r)^m = R_m(1-t)$$

<sup>12</sup> In a more refined model we would include a separate term for land cost and allow for some shifting of the tax into lower site values. See below under V, Land, for a preliminary model giving separate treatment to land.

where  $r$  is the yearly rate of return after tax

$m$  is the year of maturity

$R_m$  is the revenue in year  $m$  per dollar of cost in year 0

$t$  is the tax rate.

Substituting from (1):

$$(3) \quad (1+r)^m = (1+i)^m (1-t)$$

Solving for  $r$ :

$$(3a) \quad r = (1+i)(1-t)^{1/m} - 1$$

In (3a) one may see that  $r$  varies with  $m$ , because  $(1-t) < 1$ , and the higher the root of a number less than one the higher the value of the root, approaching unity as a limit when  $m$  is very large.

The value of  $r$  varies from a low when  $m = 1$  to a high when  $m = \infty$ . When  $m = 1$ :

$$(3b) \quad r_1 = (1+i)(1-t) - 1 = i(1-t) - t$$

This  $r_1$  will actually be negative whenever  $t > \frac{i}{1+i}$ , i.e. for all tax rates equal to or greater than a value just below the interest rate.

But when  $m = \infty$

$$(3c) \quad r = (1+i)(1-t)^0 - 1 = i.$$

The taxpayer achieves full tax exemption by investing in a tree of infinite maturity. Of course, there are none such, but the point is that  $r$  approaches  $i$  asymptotically as  $m$  rises, and the investor achieves a high degree of tax exemption by investing in a tree of, say, 50 years' life. If  $i = 10$  per cent,  $t = 50$  per cent, and  $m = 50$  years, then  $r = (1.1)(1-.5)^{1/50} - 1 = 1.1 \times .986 - 1 = .0846$ , or about 8.5 per cent, a reduction of  $\frac{1.5\%}{10\%}$ , or 15 per cent, from  $i$ . Thus a fierce nominal tax rate of 50 per cent on gross income has been tamed to a meek 15 per cent of net income. Among other things we now begin to see why timber holders fight so hard for severance taxation. It is virtual tax exemption for them, especially in the West where maturities are long.

Algebra aside, whence springs this bias? Basically it is from the deferral of tax liability inherent in longer maturities. With each passing year the taxpayer defers taxes not just on the value accruing in the current year, but on the sum accrued in all prior years. The value of this deferral grows with time so as finally to dominate the matter.

The law taxes income if and when it is *realized* in cash. But the investor constructively receives income at the time it goes to work earning more income for him. The investment value of timber (different, recall, from the liquidation value) grows at compound interest. That means

that each year its value grows enough to earn interest on the interest accrued the year before, as well as that accrued from all prior years. (Money makes money, and the money money makes makes more money.) Thus the investor has contrived to receive his income and reinvest it, but without yet paying a tax on it. (The money money made paid no tax before making more.) He can even realize this income in cash, by borrowing on the collateral of the appreciated asset, without incurring tax liability, and deduct the interest payments to boot. A tree is like a corporation that pays no dividends for decades but plows back all its earnings to increase its assets and let the shareholder take his income as deferred capital gains.

At the short end of the continuum of maturities, the rate of return after taxes is dominated by the fact that the excise tax on gross sales taxes not just net income, but also the turnover or recovery of capital. That is why the after-tax income can actually become negative for short maturities.<sup>13</sup> The power of tax deferral to afford tax exemption is dramatized when we note from our earlier example of a 50-year maturity and a 10 per cent before-tax true yield, that by waiting 50 years a taxpayer gains a major exemption of *net* income from the nominal tax rate, even though he is being taxed on *gross* income!

But at the short end capital recovery is the lion's share of gross receipts and the excise tax cuts deeply into net income. Another way of perceiving the bias toward longevity is to see the excise tax as a tax on real capital turnover—not on turnover in the exchange sense of passing from hand to hand, but in the basic Wicksellian-Austrian sense of a cycle of real investment and real recovery of capital. Each time capital cycles, in this sense, it is taxed. The tax-avoiding investor naturally therefore moves toward investments that cycle less often through time. He thus minimizes his burden, both by lowering its total value and by deferring it.

A tax that is intertemporally neutral would lower  $r$  by the tax rate for all lives, so that  $r = i(1 - t)$  at any maturity. For the excise tax there is only one intermediate year of maturity when  $r = i(1 - t)$ , and it is simply the balance of the two biases.<sup>14</sup> For short maturities  $r < i(1 - t)$  because

<sup>13</sup> If  $i = .10$  and  $t = .50$ , then for all maturities less than 6.6 years,  $r < 0$ . In general, the investor must hold long enough for money to double at the before-tax yield before the after-tax yield becomes positive, since the tax takes half the gross.

<sup>14</sup> The year is the  $m$  that satisfies equation (3) when  $r = i(1 - t)$ . Substituting and solving for  $m$  we get:

$$\frac{m = \epsilon n (1 - t)}{\epsilon n \left[ \frac{1 + i(1 - t)}{1 + i} \right]}$$

if  $t = \frac{1}{2}$  and  $i = 10\%$ ,  $m = 15$  years.

the excise tax base includes capital recovery as well as income. For longer maturities  $r > i(1 - t)$  because the benefit of tax deferral comes to outweigh the fact that capital recovery is taxed.

In summary, then, the severance or excise tax on gross receipts is doubly biased toward futurity because it both taxes capital turnover and defers the tax on unrealized income. It is more biased than any tax on net income. We have examined it in some detail because it is the first case presented and many readers will appreciate careful orientation; and because in some ways it is the simplest case, useful as a point of reference in more complex cases. It is also important in its own right: a large share of tax revenue is from excises on gross sales, many of them sales of appreciating assets.

Next, consider how the bias changes when the fisc lets the taxpayer deduct his costs. A gross bias is removed—no longer is capital recovery taxed. But the benefit of deferring tax liability is still a motive for tax avoiders to lengthen maturities.

It is here that we run counter to Professor Brown's conclusion on the subject. He based his analysis on the present value of depreciation (henceforth PVD). He noted that the longer write-off is deferred the less is the PVD for any dollar of cost; and from that concluded that, "This effect may change the ranking as to their profitability of various outlays on durable goods. Shorter-lived assets would move up the scale relative to the longer-lived." [6, 529].

We agree with Brown that the PVD is lower for longer maturities (assuming that write-off dates in practice retreat in step with cash flow, which we will later question). But we believe he overlooked the larger point that the present value of the tax liability itself also falls with futurity.<sup>15</sup> And since the gross tax liability is greater than the write-off (so long as there is any net income), the net bias is still toward longevity.

Let us now modify equations (3) to show the rate of return after taxes when the base is not gross sales, but is net income over costs. Here the taxpayer may write off or deduct initial cost,  $C_0$ , from taxable income, exempting capital turnover from taxation. This moderates the bias to futurity, but by no means eliminates it, as we will show.

The timing of write-off is important. We begin with the most plausible assumption, that costs are capitalized and written off in the year  $m$ , when

<sup>15</sup> This refers to the tax liability that would be due at the beginning of any given year  $n$  if it is deferred one year to  $n + 1$ . The effect is veiled by the fact that additional income accrues during year  $n$ , just enough to offset the drop in present value, so the present value of the growing tax liability is always the same since it grows at the rate of interest.

they are recovered. This is the actual practice with timber planting, although subject to some chiseling.

Now the rate of return after tax is:

$$(4) \quad r = [(1+i)^m (1-t) + t]^{1/m} - 1$$

Equation (4) is like (3) but for the addition of the write-off to the right side. It appears as the unwritten coefficient \$1 before  $t$  in the brackets—\$1 is the initial cost,  $C_0$ , and the value of the write-off is  $t$  per cent of \$1, or just  $t$ .

Here again  $r$  varies positively with  $m$ , although not so obviously as before. We will demonstrate this by graph and by calculus, but first illustrate it by a numerical example.

Table 1

## RATES OF RETURN AFTER INCOME TAX AT DIFFERENT MATURITIES

(when the rate before tax is constant at 8%, write-off is in year of maturity, and tax rate is 50%)

*Point-input point-output case.*

$$(1+r)^m = (1.08)^m (1/2) + 1/2$$

$m$	$(1.08)^m$	$(1+r)^m$	$r$
1	1.080	1.04	.040
5	1.469	1.24	.043
10	2.159	1.58	.047
15	3.172	2.09	.050
20	4.661	2.83	.053
25	6.848	3.92	.056
50	46.902	23.95	.065
100	2199.798	1100.40	.072
$\infty$	—	—	.08

When  $m = 1$ ,  $r = (1+i)(1-t) + t - 1 = i(1-t)$ . That is, for a one-year cycle, the investor bears the full nominal tax rate. Unlike the excise tax the income tax exempts his capital recovery, and so his income is reduced by no more than the nominal tax rate, and there is no stage of negative  $r$ .<sup>18</sup>

But for longer cycles he bears less than the nominal tax rate, as witness Table 1, which anyone may duplicate from standard interest tables.

<sup>18</sup> In this introductory paper we omit the treatment of cycles under one year. Here, so much depends on administrative practice and tax dates that a quick theoretical generalization based on simple assumptions would be misleading. Suffice it to observe that I.R.S. practice is diligent in preventing kiting practices which would benefit short investors. For example, a business is taxed on increase of inventory in a year, preventing anyone's deducting costs a year before incurring tax liability. This strictness contrasts with the laxity for long investments, and adds to intertemporal bias.

That is less intertemporal bias than the excise tax exerts, but still great. Further, the advantage of deducting costs looks dimmer when we note that the tax rate,  $t$ , must be higher under the income tax to yield the same revenue, since the base is smaller; and the impact of any bias increases with the tax rate.<sup>17</sup>

A simple graphical exposition is in Figure 1. The semi-log scale has several properties that help us visualize the case:

—any straight line from the ordinate represents a constant percentage growth rate from the y-intercept value. Thus the curve  $R = (1 + i)^m$  shows the growth of \$1., the intercept whence it begins, at  $i$  per cent, the equilibrium rate of interest. In equilibrium without taxes, all investments of \$1 grow to touch this curve at maturity.

—the steeper the straight line curve, the higher the value of  $i$  it represents. Thus a set of rays from the origin, as shown, represent different rates of return on \$1 of initial cost. Negative slopes represent negative rates of return. Doubling the rate of return doubles the slope.

—constant vertical lengths represent constant percentage changes, so  $R_m(1 - t)$  is represented by a line parallel to  $R_m$ , as shown, representing 50 per cent of  $R_m$  for all values of  $m$ .

—any curve radiating from the origin that is concave upwards represents a rate of return that rises with  $m$ , since it cuts continually higher straight rays from the origin. The lump sum received after taxes at maturity must describe such a curve, since it begins at 1 when  $m = 0$ , because  $(1 + r)^0 = (1 + i)^0 (1 - t) + t = 1$ . The curve rises slowly at first, and then approaches asymptotically the lower parallel curve,  $R_m(1 - t)$ .

—any straight curve emanating from an intercept below 1 represents likewise a rising rate of return on 1, since it cuts steeper and steeper rays from 1. But it represents a constant rate of return on the intercept value. Thus the curve shown,  $R_m(1 - t)$ , represents a constant return of  $i$  per cent on an initial investment of  $(1 - t)$ , in this example 1/2. So, as we see presently, if the fisc puts up half the initial investment by letting the taxpayer expense capital outlays it can take half the gross receipts without lowering his rate of return at all—and without gaining anything for the government except a market return on its own investment.

—the most convenient way to convert the graph into numbers is to think of money doubling every so many years at different interest rates. The

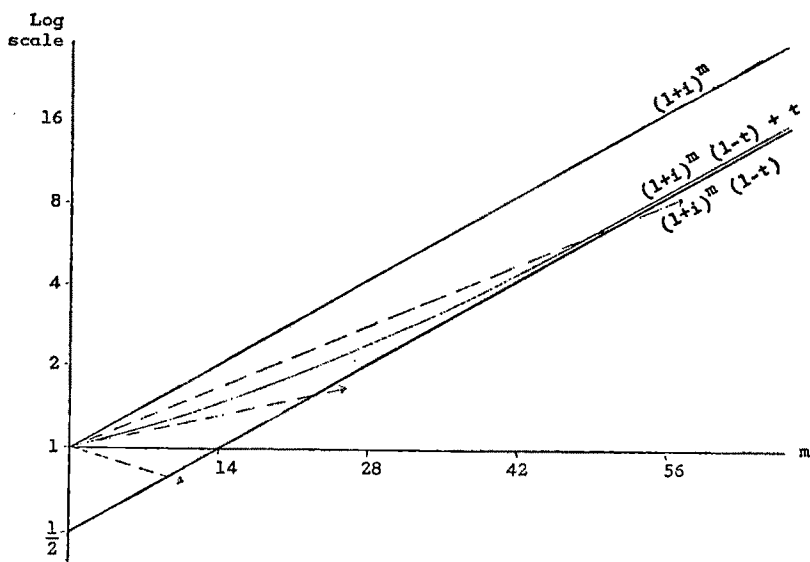
<sup>17</sup> But we would avoid much emphasis on the last point, because if we brought land into the analysis we would see that the seemingly lower tax base of the income tax is made up by the shifting of the tax benefit into land rents, which are still part of the income tax base.

numbers shown refer to 5 per cent, at which money doubles approximately in 14 years. (For computer programming, this fits the binary system nicely.)

From Figure 1 it is now evident that after-tax returns corresponding to constant before-tax returns get higher and higher as maturities lengthen. In the absence of any write-off the effect is much stronger: rates of return after an excise tax are shown in the slopes of rays that cut the lowest curve,

Figure 1

Growth of Investments at compound interest  
before and after taxes



$R_m(1-t)$ . Write-off tempers but does not eliminate the effect: rates of return after an income tax are represented in the rising slopes of rays that cut the middle curve,  $R_m(1-t) + t$ .

The decline of the present value of depreciation (PVD) with rising  $m$ , the point Professor Brown stressed, may be visualized as the diminishing vertical distance between the lower two curves as  $m$  rises. If we draw from any point on the middle curve a straight line parallel to the lower curve, its  $y$ -intercept is the present value of the middle curve discounted at  $i$  per cent. As  $m$  rises, this  $y$ -intercept falls, indicating a falling present value of the lump sum which the investor keeps after taxes. This fall is

due to the falling present value of  $t \times 1$ . This would seem to point to Brown's conclusion that investors would favor shorter maturities to advance their write-offs. We believe this to be an error.

The fallacy lies in using the wrong rate of interest,  $i$ , for discounting. We are here concerned with taxpayer incentives and the taxpayer is moved by  $r$ , his return after taxes, and not  $i$ , which includes the fisc's take. If he discounted using  $i$ , all the present values of after-tax returns would be less than \$1, an impossible result since no one would pay \$1 for an asset whose present value was less than \$1 and there would be no investment at all.<sup>18</sup>

To confirm the need to use  $r$  instead of  $i$  for discounting future rebates, the following is conclusive. Assume a point case, and a rebate,  $W_m$ , due in year  $m$ . To begin,  $(1+r)^m = \frac{(1+i)^m + W_m}{C_0}$ . The question is, is that ratio, obtained by adding  $W$  to revenues at  $m$ , equal to the ratio obtained by subtracting discounted  $W_m$  from costs at time 0? Discounting at  $i$ , the answer is no: the result is an inequality. But discounting at  $r$ :

$$(5) \frac{(1+i)^m + W_m}{C_0} \stackrel{?}{=} \frac{(1+i)^m}{C_0 - W_m(1+r)^{-m}} = \frac{(1+i)^m}{C_0 - W_m \frac{C_0}{(1+i)^m + W_m}} \\ \stackrel{?}{=} \frac{(1+i)^m + W_m - W_m}{(1+i)^m} \\ 0 = 0$$

Returning to Figure 1, any ray from the origin that cuts the middle curve has a lower slope than the top and bottom curves. Consider the topmost ray. Any parallel line above it cuts the middle curve farther to the right, and has a higher y-intercept, indicating that at the rate of return which the taxpayer uses and which guides his behavior, the longer maturities have higher present values. Of course the topmost ray may not be *the* equilibrium  $r$ ; but whatever ray does represent  $r$  it has the property that all longer maturities have higher present values, and all shorter ones have present values less than \$1 and will not be invested in at all.

We believe that the present value approach is clumsy for this purpose, and henceforth will write in terms of  $r$  as a function of  $m$ . We did think

<sup>18</sup> This same basic error appears consistently in Prof. Brown's sequel, "The New Depreciation Policy under the Income Tax: an Economic Analysis" [7]. It is, however, avoided by Prof. Musgrave, who scrupulously distinguishes before- and after-tax rates of return [23, 339]. (Musgrave denotes our  $r$  as  $i_t$ . Musgrave uses his  $i_t$  to discount future write-off rebates to present values in his equation (14-17) wherewith he analyzes straight-line depreciation. We follow the same practice for all cases.)

it necessary, however, to meet the Brown argument in its own terms, for in those terms it can seem quite convincing. The simpler refutation is to note, as we have, that  $r$  rises with  $m$ . Another refutation is to note that as  $m$  rises the taxpayer's loss due to deferring write-off of \$1 is exactly offset by his gain from deferring taxes on recovery of \$1, leaving him a net gain of deferring taxes on all income above the initial \$1 of costs. Thus Brown reached the wrong conclusion by spotlighting a lesser factor and omitting a greater one.<sup>19</sup>

For a rigorous general proof that  $r$  rises with  $m$ , it is necessary to find  $\frac{dr}{dm} > 0$ . The proof is not trivial, and appears in Appendix I.

So far we have not discussed shifting the tax, but assumed it fell wholly on the nominal taxpayer, the investor. Some readers might think the intertemporal bias would disappear as the tax is shifted, but such is not the case. Indeed, shifting is never automatic but results from reduced supply, so only the absence of shifting is consistent with neutrality in taxation.

In this case two concepts of shifting are entailed: first, shifting away from capital, which would bring  $r$  back up to the initial level of  $i$ ,  $i_b$  (the base interest rate), and would push  $i$  up to a new level,  $i'$ ; and second, shifting among maturities, which will occur whether or not the total supply of capital changes, and whether or not  $r$  reattains the  $i_b$  level.

The two concepts of shifting are separate, but related, because shifting to longer maturities has much the same effect on the bargaining power of capital vis-a-vis labor as emigration, consumption, or hoarding of capital—the other avenues by which it flees from taxation and shifts taxes. Longer maturities imply a substitution of capital for labor, as Wicksell showed, hence a reduced demand by capital for labor and a shifting of the tax to labor in the form of lower wage rates and/or higher prices.<sup>20</sup>

Shifting among maturities is inevitable, because in after-tax equilibrium it is the value of  $r$ , not of  $i$ , that investors will tend to make the same for all maturities. They will do so by shunning short investments in favor of longer ones, until the premium of short  $i$  over long  $i$  is enough to equalize short and long  $r$ .

<sup>19</sup> By way of analogy: "There was a young lady of Crete  
Who was so exceedingly neat  
When she got out of bed  
She stood on her head  
To be sure of not soiling her feet."  
—Thanks to Miss Ann Gaffney

<sup>20</sup> Longer maturities, however, increase the demand for land. Each module of "frozen labor" now requires more years of land-time before liquidation, so the effect is to worsen the bargaining position of labor vis-a-vis land. See also note 5.

Even if the aggregate capital supply were wholly inelastic, the supply at each maturity is still elastic because capital shifts into longer maturities. This elasticity of supply at any maturity is what lets capital shift the tax off the particular maturities on which it falls heaviest and spread it among all maturities.

Graphically one may visualize this on Figure 1. Imagine that the middle curve,  $R_m(1 - t) + t$ , is a curve in the road that Paul Bunyan wanted to straighten. Assume, further, that most economists remember their native folk legends. Paul hitches Babe, the Great Blue Ox, to the end of the curve and with a mighty yank pulls it straight!

This orthopraxy is not achieved without some side effects. The top curve is rigidly connected to the middle one by the requirement that they differ by  $t(R_m - 1)$ . So the top line develops a curve. It becomes concave downwards, a mirror image of the middle curve shown on Figure 1. This mirror reflects the fact that  $i$ , the gross-of-tax rate of return, must now be higher for shorter maturities, in order that  $r$  be the same for all.

Stephen McDonald has developed an ingenious thesis about such shifting that might temper the basic effect. He points out that shifting by industries whose operations entail shorter maturities is easier because the gross returns comprise less return *on* capital and more return *of* capital, the second representing payments to labor and other initial inputs. Indeed, McDonald goes so far as to conclude from this that the tax biases investors against longer maturities. We believe that he has taken a responsive, equilibrating effect and made it the prime mover, overlooking the initial cause: the force that initiates shifting is a move to longer maturities. The McDonald effect<sup>21</sup> might temper the primary movement but could not overpower it because without the initial cause there would be no McDonald effect. Shifting may or may not be easier at shorter maturities, but what reallocation does occur will have to be toward longer maturities.

We believe that McDonald's thesis is also open to the criticism that slower maturing investments, while the value of their final product contains a high interest component, as timber, also consume years of land-time and have a high component of land rent. So while shifting to labor is harder, shifting to land is easier, and it is not certain that on balance the longer maturities will impede shifting.

We began by observing that the timing of write-off is important, and assuming that it occurred at maturity,  $m$ . Now let us see how advancing the date of write-off affects intertemporal bias. We will show that it

<sup>21</sup> We do not here judge the quantitative importance of the effect, which we regard as plausible and ably argued but as yet moot. See also note 11.

appears to reduce intertemporal bias, but that the appearance is deceptive because it does so only by eliminating the tax [23, 343-44].

Let  $w$  be the year of write-off. We have so far let  $w = m$ . Now let  $w = m - 1$ . The write-off now yields the investor one year's interest before maturity, so the value to him at  $m$  of the two lump sums he gets is  $R_m(1 - t) + t(1 + r)$ .

Note that the year's interest gain to the investor is at the rate  $r$ , and not  $i$ .  $r$  is the rate which he can get and keep for himself by investing the write-off dollar a year before maturity. To compound the write-off at the rate  $i$  would overstate its value to the investor.

Now let  $w$  fall, and  $t(1 + r)^{m-w}$  rises. Interest earned by the write-off dollar helps pay the tax at  $m$ . As  $w$  moves toward zero, the middle curve in Figure 1 both rotates upward and straightens out. If this is not intuitively obvious, it becomes so when we consider the extreme case when  $w = 0$ , *i.e.* when the taxpayer may write off capital investments as though they were current expenses ("expense" them). Then, interest earned by the write-off dollar pays the *entire* tax at all maturities, and the middle line becomes the same as the top line.

This straightening indicates the removal of tax bias. By letting investors expense capital investments we have removed bias from taxation. This discovery might be a boon to mankind like fire or the wheel but for one flaw: it also eliminates the tax.

Algebraically, the point is clear by solving for  $r$  when  $w = 0$ .

$$\begin{aligned} (6) \quad (1 + r)^m &= (1 + i)^m (1 - t) + t(1 + r)^{m-0} \\ (1 + r)^m (1 - t) &= (1 + i)^m (1 - t) \\ (1 + r)^m &= (1 + i)^m \\ r &= i \end{aligned}$$

The taxpayer gets the full rate of return. All the fisc gets is a market return on its own investment of  $t$  per cent of \$1 at time zero. The easiest way in general to view this case is that the taxpayer and the fisc have been partners in this investment. The fisc puts up  $t$  per cent and the investor  $(1 - t)$  per cent. Each earns  $i$  per cent on its share of the investment.

It would be misleading to think of expensing as an approach to neutrality, therefore. A neutral tax must first be a tax. It would also be mis-

leading to think that some halfway measure like making  $w = \frac{m}{2}$  would lessen intertemporal bias, for that would reduce revenue and require a higher tax rate to maintain revenue. That would actually increase bias as may be seen by shifting the lowest curve in Figure 1,  $R_m(1 - t)$ , downwards.

But while expensing does not convert the income tax into a neutral tax on that capital which turns over, it does contain an important element of neutrality which we have not brought out yet. Land does not turn over, and the Internal Revenue Service, although it does many strange things, in this case quite properly and logically rules that land purchase is not a cost and may not be depreciated and written off, much less expensed. Expensing effectively exempts from tax the income of expensable investments, but not of land. Thus it tends to convert the corporate income tax, which exempts wages, into a tax on land income.<sup>22</sup>

Since land income is rent, the tax may be neutral. However, tax neutrality requires more than a base which is rent, *i.e.* a base whose supply within the tax jurisdiction is fixed. Rent is a surplus which *may* be preserved unabated by skillful taxation, but not one which *cannot* be destroyed by taxation. As a means of taxing land rent, expensing of capital investments under the corporate income tax has some merit, but on the whole seems to us less promising than the conventional approach of modifying the ad valorem property tax to exempt capital. So we will not pursue it other than to summarize the faults we find:

—expensing in practice discriminates against investments of less than one year's maturity (which are a large share of the gross investment flow) because the tax calendar is discontinuous. To achieve exemption, an 11-month investment would have to be expensed at the beginning of month 0 and taxed at the beginning of month 11; in practice it would be taxed and expensed simultaneously.<sup>23</sup>

—expensing can only be neutral for long run decisions *ex ante* the investment. *Ex post*, all short run decisions are biased by the tax rate on gross cash flow, which operates just like an excise tax. This rate might have to be higher to compensate for exempting so much.<sup>24</sup> The short run bias would then reflect back and affect the long run decision *ex ante* investment, since the investor would anticipate his later short run reactions. Only if the initial investment were completely irreversible and controlling, so no later adjustments were possible, would the tax be neutral.

<sup>22</sup> Or would, if the fisc maintained tax rates on the remaining income. Congress has been generous in extending the expensing privilege to oil men, for example, but then it also exempts their rent income by the depletion allowance.

<sup>23</sup> In addition, the current "investment tax credit," a species of partial expensing, is not fully allowable for investments unless their life exceeds 8 years, a most explicit bias against short maturity. This and other measures suggest it actually is the intent of Congress to favor long maturities.

<sup>24</sup> This is advanced tentatively, because some of the advantages will be shifted to land rent, and still be part of the tax base therefore. We have reserved treatment of this important issue for a sequel.

—the advantage of expensing is denied to new, small, and losing firms, which have no outside income against which to write off new investments. —after write-off in time zero the investor is locked in, *i.e.* he cannot sell an immature asset in year *n* without incurring his accrued tax liability, whereas if he holds to maturity he defers the tax accrued by year *n* to year *m* without increasing its amount, a clear gain. Thus the market in longer maturities is virtually destroyed. The net loss of investor welfare, as earlier noted, is mitigated because the assets are still bankable; but an economical allocation of resources may be blocked, and vertical integration to defer tax liability receives a big boost with resulting damage to competitive market structure.

—in practice, investors have learned to disguise land purchase as purchase of old buildings on land, and write off much of it, often more than once. Unless this practice were drastically reformed, investors would expense land purchase too and the tax would have little or no base at all.

—taxation of the current yearly appreciation of land prices, which is income just like appreciation of trees, would still be deferred until sale, or if never sold, forever. Land appreciation may be converted to cash at any time, not just by banking on it (mortgaging it) but, more commonly, by consuming the cash recovery from other assets, especially the buildings on the land in question,<sup>25</sup> and relying on the land value increment as the sinking fund.

Universal expensing of capital investments would have the very real advantage of making general one invidious advantage now granted explicitly to oil ("intangible" well costs and dry holes), to R & D (research and development), to advertising and other "intangible" costs, and taken implicitly in a dozen devious ways: by gentleman farmers who build up old farms by "losing money" on capital improvements written off as current expenses; by utilities which suffer current losses in new territory to nail it down for future exploitation; by oligopolists who incur current losses in price wars to secure future markets, or underwrite premature suburban retail outlets to secure position; by land developers who sell or rent the first units at a loss in order to enhance the others; by land speculators who lose money operating nurseries or farms or drive-ins so they can satisfy the I.R.S. rule that the land is used in their business, and qualify for capital gains; *et hoc genus omne*. Further, universal expensing

<sup>25</sup> ". . . depreciation funds are seldom provided for the buildings in New York, dependence being placed upon the increase in land values to counterbalance the decrease in building values through wear and tear." See Robert Haig, "Some Probable Effects of the Exemption of Improvements from Taxation . . ." [16, 133-34].

would make general the advantage of deferred tax liability now reserved for appreciating assets. If, upon realizing income, I can immediately reinvest it and write it all off, I have no tax to pay, and am as well off as though my original asset had continued to appreciate without being taxed.

On balance, however, we do not recommend expensing as the best way to tax land rent since the ad valorem property tax on land values is an available alternative which lacks the faults just listed. Land value is the sum of future discounted income less costs, with all costs, including capital costs, dated at the time they are expensed. Levying on the land value base, therefore, is the counterpart of expensing under the corporate income tax, with the difference, of course, that the ad valorem approach bases the tax on assessment of the land's market price or opportunity cost rather than on records of the present owner's receipts and expenses.

So far we have considered write-off at maturity,  $w = m$ , and expensing,  $w = 0$ . There are other possibilities, which we now entertain: a constant  $w$  independent of life,  $w = k$ ; a  $w$  always  $k$  years short of life,  $w = m - k$ ; and a  $w$  always some fraction of life,  $w = \frac{m}{k}$ .

If  $w = k$  the bias to longevity is much greater than if  $w = m$ , obviously, because longer life defers tax liability, just as with the simple excise tax on gross, but does not defer write-off. Maturities less than  $k$  are especially hard hit.

This might seem a fanciful case, but far from it. We remarked earlier, in discussing Cary Brown's thesis, that we would question the realism of assuming  $w = m$  in fact. The write-off periods of assets tend to be based on arbitrary lives specified in I.R.S. *Bulletin F* or Revenue Procedure 62-21. Lawyers tend to think in categories, not continua. More durable plant and equipment of a category given 15 years in *Bulletin F* are most likely to get 15 years, regardless of actual life.<sup>26</sup>

If  $w = m - k$ , the bias would be against longevity. Maturities of less than  $k$  would be written off before they were born; and by turning capital rapidly one could drain the Treasury. This is a fanciful case!<sup>27</sup> Not that no one is allowed to drain the Treasury, but the privilege is reserved for investors with long maturities.

<sup>26</sup> Breeding cows get 8 years, for example: producing lives may be as high as 15 years. See Oppenheimer's *Cowboy Arithmetic* [24].

<sup>27</sup> Under these rules: "There was an investor named Bright  
Whose money moved faster than light  
He invested one day  
In a roundabout way  
And cashed in on the previous night."

If  $w = \frac{m}{k}$  the outcome is somewhere between  $w = m$  and  $w = 0$ . The return after tax is shown in equation (7) where  $k = 2$ .

$$\begin{aligned}
 (7) \quad (1+r)^m &= (1+i)^m (1-t) + t(1+r)^{m-m/2} \\
 (1+r)^m [1-t(1+r)^{-m/2}] &= (1+i)^m (1-t) \\
 (1+r)^m &= (1+i)^m \left[ \frac{(1-t)}{1 - \frac{t}{(1+r)^{m/2}}} \right]
 \end{aligned}$$

As  $m$  gets large the right fraction approaches  $(1-t)$  as a limit and the case resembles earlier cases, Equations (2) and (3), where  $r \rightarrow i$  as  $m \rightarrow \infty$ . Formal rigorous proof that  $r$  rises with  $m$  follows the lines of Appendix 1. Arithmetic illustration follows the lines of Table 1. We omit these exercises because they are repetitive variations on a theme.

An easy near-proof is to take the natural log of both sides of (7).

$$(7a) \quad m \cdot \ln(1+r) = m \cdot \ln(1+i) + \ln(1-t) - \ln[1-t(1+r)^{-m/2}]$$

But when  $r$  is in the normal range of interest rates:

$$\ln(1+r) \cong r, \text{ and } \ln(1+i) \cong i,$$

and so:

$$\begin{aligned}
 (7b) \quad r &= \frac{mi + \ln(1-t) - \ln[1-t(1+r)^{-m/2}]}{m} \\
 &= i + \frac{\ln(1-t) - \ln[1-t(1+r)^{-m/2}]}{m}
 \end{aligned}$$

The only thing that keeps  $r$  below  $i$  is the fraction on the right (note that it is negative) whose denominator is  $m$ . As  $m$  rises, this fraction declines in relative weight, and  $r$  rises to approach  $i$ .

So even under the write-off assumption most favorable to brevity and still levying a tax, the bias is to longevity. There is no escaping it, so long as taxation waits on realization. Equation (7b) is generally applicable to all the point-input point-output cases. Simply replace  $\frac{m}{2}$  by whatever value  $w$  has; or if no write-off is allowed strike out the second  $\ln$  in the numerator altogether.

It is easy to tear down. Let us turn now to reconstruction. How might we levy an intertemporally neutral tax on the income of capital? We begin with some criteria learned above.

- a. Initial costs must be deductible, to avoid taxing capital turnover.
- b. Unrealized appreciation must be taxed as it accrues, not waiting for

realization in cash.<sup>28</sup> Thus tax liability is not deferrable by lengthening maturity.<sup>29</sup>

c. Write-off must synchronize with capital recovery; earlier write-off grants partial or complete tax exemption.

The investment value of our immature trees in equilibrium grows at the rate of interest,  $i$ . An income tax as above would take each year the tax rate times the base  $V \cdot i$ . There would be no other tax because at maturity all appreciation would already have been taxed; and the write-off of initial cost,  $C_0$ , would exactly offset the recovery of  $C_0$ .

The reader's skepticism may rise when he suddenly realizes that our neutral income tax is very like a property tax on standing timber: it takes a percentage of the market value each year! Can a tax in such bad odor actually be a good one?

The neutrality of the tax is shown as follows:

$r$  is defined in Equation (8).

$$(8) \quad \$1 = \frac{-it}{1+r} - \frac{i(1+i)t}{(1+r)^2} - \dots - \frac{i(1+i)^{m-1}t}{(1+r)^m} + \frac{(1+i)^m}{(1+r)^m}$$

which says that the present value of gross receipts less the present value of taxes must equal the initial cost of \$1. Summing the geometric progression and switching the last term to the left side:

$$(8a) \quad 1 - \left( \frac{1+i}{1+r} \right)^m = \frac{-it}{r-i} \left[ 1 - \left( \frac{1+i}{1+r} \right)^m \right]$$

$$r-i = -it$$

$$r = i(1-t)$$

And this holds true for all  $m$ .

The rationale of the tax, and its intertemporal neutrality, stand out clearly when we consider what the tax would be if we let the amount due accrue in a sinking fund. The present value at time zero of the taxes is, from (8).

$$(8b) \quad PVT_0 = \frac{it}{r-i} \left[ 1 - \left( \frac{1+i}{1+r} \right)^m \right]$$

$$\text{But } \frac{it}{r-i} = -1$$

<sup>28</sup> Alternatively, to avoid liquidity problem cases, unpaid accrued taxes might be let grow in a sinking fund at interest, to be paid in cash at maturity. But the appreciated asset is always bankable, averting liquidity crises. Of course, the owner must then pay interest on the loan, but that is the whole point.

<sup>29</sup> It is as though the tree were sold each year, from one investor to another, so the whole time-consuming ripening process were "vertically disintegrated." The need for that is very clear upon considering one of its incidental benefits, which is to avoid discrimination between long-haul investors and quick in-and-out investors, and to avoid encouraging vertical integration to defer taxes.

So the value in year  $m$ , compounding at  $r$ , is

$$(8c) \quad VT_m = (1+i)^m - (1+r)^m$$

That is, if we gave the taxpayer the choice of paying at maturity with interest, his tax burden would grow exponentially, like money in the bank, at a rate of interest equal to  $r$ , maintaining intertemporal neutrality of choice by maintaining a constant difference between  $i$  and  $r$ .

The remarkable fact emerges that the neutral income tax is like the property tax on standing timber! Can it be that this pariah of taxes, which we have scourged out of the system to the cheering of economists, was actually neutral?

It is neutral if we assume, as we have, no shifting of the tax, *i.e.* that capital bears it wholly in a lower  $r$ .

But that is not a very realistic assumption; neither is it permissible in a proof. To assume the absence of shifting of any kind is to assume tax neutrality, since it is tax-induced reallocation of inputs whose supply is elastic that causes tax shifting. We cannot prove a tax is neutral by assuming that it is. In Figure 1 we could prove the tax on realized interest income was *not* neutral, regardless of shifting to other inputs, because of intertemporal shifting. We have shown the tax on accrued interest income is intertemporally neutral if not shifted to other inputs. But now we must ask, what happens to intertemporal neutrality if it is so shifted?

Suppose a property tax is levied in a jurisdiction too small to influence national or world interest rates at all. Investors need not accept lower returns there than elsewhere, so capital emigrates until the tax is completely shifted.

Now capital is scarcer there and needs to be rationed at a higher interest rate. To ration this reduced supply best, a tax system needs to bear equally on all maturities. That is what the property tax and our neutral income tax would accomplish. Capital must now earn  $i$  (the gross-of-tax rate of return) in all uses and maturities to return to the taxpayer an after-tax return,  $r$ , that is the same for all uses and maturities.

Because capital is scarcer, some former uses of it must be abandoned. The question is, which ones? Under the property tax, capital-intensive enterprises are hardest hit, as forest owners have always complained. But that is as it should be: if capital is scarce, capital intensity is wasteful.

Capital longevity is of course synonymous with capital-intensity. Long-lived trees that tie up capital for 80 years or so become submarginal under

the property tax. The jurisdiction's scarce capital supply is marshaled into shorter-lived investments.

The property tax and our accrued-income tax are neutral in this sense: once the decision is made to tax interest income and accept the consequent scarcity of capital, then the reduced supply is economically rationed by requiring all investments to earn  $i$  before taxes. The tax is neutral among all maturities at the higher rate of interest,  $i$ , which is now the equilibrium rate.

Higher interest rates of course tend to ration out longer maturities, and the result is to shorten lives. This bears the semblance of a tax bias against longevity, but that is not a meaningful way to perceive it. It is the tax-induced capital shortage that causes the bias against longevity. Our tax then rations capital economically under this new constraint.

Compare, now, the result of a tax on realized income if the tax is shifted. This bears lighter on longer maturities, and so causes the jurisdiction's scarce capital to be tied up in capital-intensive enterprises—exactly the wrong allocation to meet a shortage. It spares the investments that are marginal by virtue of longevity, but hits others. Capital is forced out of higher uses rather than lower uses.

There might appear to be some benefit in the realized-income tax basis to compensate for the bias to longevity, in that capital finds a tax shelter in long maturities and less of it need be driven to emigrate. But that would be a false hope to pursue. By avoiding taxes, capital deprives the fisc of revenue, forcing higher tax rates to yield the same revenue. The higher rates force out more capital, leaving us finally with less capital and more intertemporal bias. We cannot take comfort in the hope that tax avoidance for capital will be imputed into higher taxable land rents, as in the expensing case, because the same deferral of realization of income by which capital avoids taxes also defers realization of the associated land rents and lets land escape as well. In comparing the income tax and the excise tax we could truly say that the taxpayer benefits of the former over the latter would be imputed to land and so not escape from the tax base, because the income tax has less longevity bias than the excise tax. But now we are comparing the income tax and the property tax. The taxpayer benefits of the former over the latter are also shifted to land, but they *do* escape from the tax base even so because the resulting increase of land rents is deferred.

The only reason for preferring the realized basis, therefore, would be to dissemble: to appease voter clamor for taxes on property income while

actually letting it escape. It is easy to imagine and to observe how such a device could be and is useful in politics. But it is not the function of economic science to supply ruses to mislead voters; it is rather to recommend the best possible policies in the public interest.

Let us summarize. Our accrued income tax, and the property tax which it resembles, are neutral intertemporally if capital absorbs the full tax without shifting. If capital emigrates to escape the tax, the emigration is itself a tax-induced misallocation, and the tax is not neutral. Only a tax on land, which cannot emigrate, can be fully neutral. But if society does tax interest income, our accrued-income tax base preserves intertemporal neutrality among investments at that higher rate of time-discount appropriate to the tax-induced scarcity of capital. Thus the accrued-income basis is distinctly superior to the realized-income basis of taxation, containing an important element of neutrality which the latter lacks, and the possibility of complete neutrality under the special and unrealistic assumption of non-emigration and non-shifting, or under the assumption that the property tax base has been modified to exempt improvements.

Historical opposition to and criticism of the property tax has resulted from the tax's making very visible the destructive effects of taxing the income of a mobile, migratory input like capital. That has been especially true in forestry. But shifting to the realized-income basis makes the tax no less destructive, only less conspicuously so. In the process of concealing the damage, however, the income tax adds greatly to it by driving capital into longer maturities. It also sloughs the tax burdens of property onto labor, which lacks equally effective means to avoid taxes.

*(Continued)*

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### *Cooperation in Antarctic Research*

FIFTY SCIENTISTS from 12 countries which are signatories to the Antarctic Treaty, including the United States, Britain, Japan, and the Soviet Union, met in Tokyo in 1968 for the 14th general meeting of the Scientific Committee on Antarctic Research. The group decided on the establishment of an international cooperation system on geological studies, joint studies on logistical problems, and creation of a telecommunication system in the Antarctica. [From the U.S. Department of State.]

*In Memoriam: Grover Cleveland Loud, 1890–1968*

GROVER CLEVELAND LOUD was born in Boston on November 5, 1890 and died in Laconia, New Hampshire, on August 29, 1968. In the seventy-seven intervening years he lived a memorable life.

Grover Loud was an editor's editor, a scholar with special competence in areas like literature and religion, and a stickler for accuracy and concreteness of expression, for felicity of style, for logical organization of material and clarity of exposition. And he himself was also a master of the writers' craft.

But he achieved the top rank of his profession, journalism, also because of his unmis-takable personality. Tall, thin, spare and sharp-featured, with an unruly shock of sandy red hair, uttering sage and profane comments in a nasal twang without removing the inevitable corn-cob pipe from his lips or the plug of tobacco from his jaw, he made work a delight to all about him. As one of his co-workers recalled:

"In moments of relaxation, he regaled his colleagues with anecdotes of Indian life and the worlds of the theater and music, of which he was a part. He was a superb raconteur, with an actor's flair for expression and a dramatist's talent for building a story to a climax."

Reared in Moultonville, N.H., he acquired there his love for country living. At Harvard College, where he graduated in 1913 with a bachelor's and a master's degree in arts, he gained his reverence for language and literature. He taught English literature and composition—with time out for service in France during the first world war when he was severely wounded, carrying shrapnel to his grave—at Dartmouth College, the University of Kansas and at Brown and Marquette Universities.

He had worked his way through Harvard as a newspaper reporter and in 1919 he returned to the craft as a reporter for the *Boston Herald*, becoming the paper's New York correspondent the following year. He joined the *New York Times* in 1923 as a copy editor, remaining in the post, except for a few years as telegraph editor, until his retirement in 1964 to Centre Ossipee, N.H., where he and his wife, the former Eva Blake, maintained their home. There, with his wife, their son, grandson and two great grandchildren, he enjoyed four blissful years, writing a little, reading a lot and savoring country life.

Grover Loud was one of the group at The Players in New York, including Albert Jay Nock, who were quickened by the social philosophy of Henry George, one of the interests that contributed to our lifelong friendship. He helped me in establishing the monthly *Freeman*, serving as Frank Chodorov's editor when I found it necessary to withdraw. He aided in my efforts to bring the work of Franz Oppenheimer to the attention of American scholars and he never refused a request that he write for this *Journal*. When work assignments permitted he was a devoted member of the Francis Neilson Coterie, adding wit and wisdom to its deliberations. As a man of letters and as a man of noble character he enriched all who knew him.

WILL LISSNER

# Academic Self-Image as a Strong Determinant of College Entrance and Adult Prospects:

## *Relative Deprivation Theory Applied to High School Curriculum Choice*

By WALTER ADAMS\*

### I

#### The Theory of Relative Deprivation

SHORTLY AFTER THE END of World War II the sociologist, Samuel A. Stouffer, and a number of his colleagues published their massive study, *The American Soldier*.<sup>1</sup> One of the concepts developed by the authors, at the time a rather novel one, was the basis of the theory of relative deprivation. As applied to the Army the argument went somewhat as follows:

Soldiers appear to measure their personal success by standards based on experience in the particular units in which they serve, rather than by standards prevailing in the armed forces in general. In units where promotion is infrequent, failure to achieve it involves little or no loss of self-esteem. Where promotion is frequent, failure to achieve it represents failure. Unfamiliarity with standards in other units is sufficiently great so as to exclude them from measures of personal progress.

Various attempts have been made to apply this concept of relative deprivation to areas of life other than the military. One of the more recent is that of James Davis, who presented survey evidence that college students base their career choices more upon academic performance relative to their classmates than upon objective measures of their own knowledge and ability. Students with better grades who are attending academically unselective colleges appear more likely to formulate ambitious career plans than students with poorer grades at highly selective colleges—despite the fact that the latter students are at least as able as the former ones.<sup>2</sup>

\* Research associate, Bureau of Applied Social Research, Columbia University. This article is part of a larger study in progress (A. J. Jaffe, director) at the Bureau of Applied Social Research. The research is supported by the U.S. Office of Education.

<sup>1</sup> S. A. Stouffer, *et al.*, *The American Soldier: Adjustment during Army Life* (Princeton, N.J.: Princeton University Press, 1949).

<sup>2</sup> James A. Davis, "The Campus as a Frog Pond: An Application of the Theory of Relative Deprivation to Career Decisions of College Men," *American Journal of Sociology*, Vol. 72, No. 1 (July 1966). See also, Charles E. Werts, *The Study of College Environments Using Path Analysis*, National Merit Scholarship Corporation, Research Report, Vol. 3, No. 4 (1967), Evanston, Ill.

If Davis' findings should be valid, and if the evidence he presents is persuasive in spite of limitations in his data, they would raise questions regarding a number of common assumptions about higher education. For example, is the academically superior college (presumably the highly selective college is such a college in most instances) the desirable college for all students, irrespective of their measured abilities and pre-college preparation? Or would a student of simply average ability in a class of unusually able students tend to under-aspire in his occupational choice, and in consequence under-achieve in later life? If one considers the current drive to bring Negroes to highly selective campuses where they are currently so under-represented, would these students benefit or suffer over the long term from attendance at such schools?

Davis's analysis raises these and other questions regarding the relationship between relative academic status at the college level and post-college performance. But the basic premise, that of a strong correlation between relative assessment of self and choice among available options, might well pertain most significantly during the pre-college years.

In point of fact, as we shall see, rather early in his or her high school career a student selects a particular academic program which, once entered upon, is usually followed for the remaining high school years. The choice between the college preparatory course and other programs is the earliest major option open to most students, and one upon which later options (such as entering a desirable 4-year college) in large part depend. It would seem especially relevant to assess the factors related to the educational "cooling out" process at the earliest point where a significant choice between alternatives is offered—that point at which a highly disparate population of high school entrants, representing very nearly the total age cohort, presumably should present very clearly the differences strongly associated with varying levels of educational aspiration.

## II

### Our Data and Analysis

IN THE PAGES which follow we shall attempt to determine the extent to which a high school student's estimate of his own brightness, relative to that of his classmates, is a determinant of the kind of high school program he enters.

Our data derive primarily from a secondary analysis of the responses of a national sample of over 90,000 12th grade students in 1965, representing a portion of the respondents from the Office of Education's bench-

mark survey, *Equality of Educational Opportunity*, commonly identified as the Coleman study.<sup>3</sup>

Our second major data source is a follow-up survey of a national sample of 1965-66 high school seniors in February 1967, conducted by the Census Bureau, to determine the post-graduation behavior of these seniors. The Census data permitted us to determine the relationship between the high school curriculum followed and college entrance, and for those entering college the relationship between curriculum and the type of college entered.

The Coleman data permitted us to investigate relationships between various student characteristics and the type of high school curriculum a student selected. At this point let us consider briefly our approach to the Coleman data.

If there is a strong relationship between relative academic self-image and the type of high school curriculum chosen, this fact alone would not prove that it is relative deprivation, or its converse, which is responsible for the choice. It might well be argued that the students who feel least able relative to their classmates are indeed the least able ones, and so the least likely to enter college preparatory programs. The "hidden variable," actual academic capability, might be the determining one. Similarly, a student's relative academic self-assessment might reflect his socio-economic background. A strong relationship may exist between parental educational attainment and a student's academic self-appraisal. The educational tradition in the home, rather than the perceived position in the classroom academic continuum, might be the underlying determinant of program choice.

Accordingly, our tabulations control for the student's actual academic capability as evidenced by test-performance according to national norms. They also control for socio-economic background, roughly measured by the mother's educational attainment. With these controls we were better able to determine the relative significance of objectively measured ability, perceived relative brightness, and parental educational attainment, for choice of high school curriculum.

The importance of the high school course of study elected depends, of course, upon the extent to which it predicts post-high school behavior. Accordingly, we present evidence on this fundamental question.

Finally, we should mention the limits of our data—questions for which we cannot offer any answers. We cannot say to what extent a student's

<sup>3</sup> James A. Coleman, *et al.*, *Equality of Educational Opportunity*, OE 38001, Office of Education, Washington, D.C., 1966.

academic self-image accurately reflects his real academic position in his class. We assume a considerable measure of validity in such self-appraisals; but we also recognize that to some unknown extent academic self-images undoubtedly reflect psychological factors such as self-confidence, general self-esteem, and so forth. Nor can we determine whether the academic self-image is formed prior to high school—that is, to what extent this self-image in high school reflects early relative assessments of self on the part of the child. Any remarks we may make on such questions are simply speculations, and our survey data can offer them no support.

### III

#### The Orgins and Stability of the Student's Academic Self-Image

OUR DATA RELATE to high school seniors, rather than to students in their freshman year when the curriculum decision is in fact made. Is it possible that an unfavorable self-image, for the senior, is to some degree an effect of having followed the less prestigious non-college preparatory program? Does the self-image emerge in the course of the high school career, or is it a constant throughout that career?

Apart from the possible influence of the curriculum upon the student's academic self-image, there should be little reason for the image to change between the 9th and 12th grades. The school itself represents a stable academic environment. The relative socio-economic position of most students is unlikely to change significantly. Even intelligence, for this age group, is a relatively firm characteristic. As S. A. Kendrick observes: "Virtually all the controversy over fixed intelligence focuses upon the very early years. At the high school ages, growth curves tend to be quite flat and tests (which are usually verbal tests) correlate very highly with themselves over a period of one or several years."<sup>4</sup>

It could be argued, however, that a high school senior estimates his personal self-image on the basis of the overall ability of the group with which he associates—the college preparatory or non-college preparatory students. On the other hand, to the extent that he bases his self-image on marks, the non-college preparatory student, as compared to the college preparatory student at the same ability level, should tend to have a relatively favorable academic self-image. The evidence to this effect, from the Census Bureau survey, is given in Table 1.

Comparisons between non-entrants and 2-year college entrants illustrate

<sup>4</sup> S. A. Kendrick, "The Coming Segregation of our Selective Colleges," *College Board Review*, No. 66 (Winter 1967-68), p. 12.

our inferential conclusions. Two-year college entrants are about three times as likely as non-entrants to have followed college-preparatory programs. The former group is over half again as likely as the latter one to include high ability students, but is appreciably less likely to include students who earned high marks. Presumably the less able and primarily non-preparatory students benefit in their marks from the less rigorous programs they tend to follow, and from the less rigorous competition from classmates. Accordingly, to the extent that marks influence academic self-images, their self-images should also benefit.

Admittedly we have no direct evidence from our data on how and when the academic self-image is formed. In general, however, the social-

Table 1

## COLLEGE ENTRANCE RECORD OF 1966 HIGH SCHOOL GRADUATES

Student Characteristics	Did not enter college (per cent)	Entered a 2-year college (per cent)	Entered a 4-year college (per cent)
Ability score			
High	19	29	62
Medium	81	71	38
All levels	100	100	100
Average high school marks			
B - or better	45	39	73
C + or better	55	61	27
All levels	100	100	100
High school curriculum			
College prep.	19	56	84
All other	81	44	16
All curricula	100	100	100

NOTE: The small number of cases precludes 3- and 4-variable tabulations.

psychological literature supports our belief that self-assessments are relatively stable by the time a child reaches high school. For example, a 1954-56 follow-up study of a sample of 8th, and subsequently 10th, graders found that the "overall mean correlation between self-concept in 1954 and 1956 (was) .78."<sup>5</sup> The principal type of change in self-concept was for children with somewhat "dim" initial views of themselves to have even "dimmer" ones two years later. Children with generally favorable initial self-concepts seldom differed two years later. Self-concept (posi-

<sup>5</sup> Mary Engel, "The Stability of the Self-Concept in Adolescence," *Journal of Abnormal and Social Psychology*, Vol. 58, No. 2 (March 1959), pp. 211-16.

tive or negative regard for self, scored from an inventory of questionnaire items) is not identical with academic self-image. However, the Coleman study asked the high school seniors for their estimated social statuses relative to classmates, as well as their academic statuses. The relationship of the social variable (upon which we are not reporting in this article) to high school program choice, verbal ability, and mother's education parallels that of academic self-image at every point. Perceived social status and academic self-image were themselves closely and positively related. We simply assume, then, that academic self-image is one element of a relatively unified and consistent overall self-assessment, and consequently should partake of the general stability of such assessments which social psychologists have found during the adolescent years.

Table 2

MAJORITY GROUP SENIORS\* VERBAL ABILITY BY ESTIMATED RELATIVE  
BRIGHTNESS COMPARED TO CLASSMATES, AND BY  
POST-HIGH SCHOOL PLANS

	High ability		Medium ability		Low ability	
	Above average brightness	Average or below brightness	Above average brightness	Average or below brightness	Above average brightness	Average or below brightness
	(per cent)	(per cent)	(per cent)	(per cent)	(per cent)	(per cent)
No college plans	13	34	28	50	44	65
College probably	18	29	27	29	30	25
College definitely	69	37	45	21	26	10
All plans	100	100	100	100	100	100
No. of cases	20,809	7,242	9,041	18,801	974	4,505

If it should be true that the academic self-image is appreciably modified by the program a student follows, this would not invalidate our claim that a strong relationship exists between self-image and the level of educational aspiration. It would merely add an intermediate link to the chain of causation for that image. However and whenever formed, the self-image is strongly related, for high school seniors, to post-high school plans. (We estimate that about 18 in 20 college-planners enter college eventually, plus about 3 in 20 non-planners.) The data in Table 2 derive from the Coleman data, and present academic self-image at the point at which post-high school intentions are declared.

\* Majority group seniors include white and Oriental American students

The findings for minority seniors (chiefly Negro) parallel those for majority seniors in all particulars, though the relationship between each of the two academic variables and plans is slightly weaker. But the major point is that the academic self-image a student has in the last year of high school is a consistently powerful independent determinant of post-high school plans.

In the balance of this article we shall simply assume, as we believe the available evidence strongly suggests, that a student's academic self-image is at least reasonably stable throughout his high school career.

## IV

## The High School Curriculum and College Attendance

HOW WELL DOES THE COURSE of study a high school graduate has pursued predict his behavior the following academic year? The answer is in statistics from the Census Bureau's February 1967 follow-up of 1965-66 high school graduates, summarized in Table 3.

Table 3  
COLLEGE ENTRANCE RECORD OF 1965-66 GRADUATES

Post-high school behavior	High school program		
	College Preparatory (per cent)	All other programs (per cent)	All programs (per cent)
Did not enter college	22	78	53
Entered college	78	22	47
2-year college	20	13	16
4-year college	58	9	31
All eventualities	100	100	100
Number	1,175,631*	1,436,882*	2,612,513*
Per cent	45	55	100

\* Survey respondents inflated to national totals

There are three clusters of significant findings which emerge from Table 3:

1. The high school program pursued very nearly divides the graduates in half. Forty-five per cent were college preparatory students, and 55 per cent had followed other courses—commercial, vocational, general, and so forth. If the high school program should prove a strong predictor of post-high school behavior, large groups of students should be differentially affected.

2. Nearly four in five of the college preparatory graduates entered col-

lege immediately. Only slightly over one in five of those who followed other courses did so. The college preparatory program is clearly the principal path leading to higher education.

3. Nearly eight in ten of the college preparatory students who entered college entered 4-year schools; this was the case for only about four in ten of the non-college preparatory students. For whatever reasons, the high school course of study was a strong determinant of the type of college entered, as well as of college entrance *per se*.

Unfortunately our data cannot answer several significant questions which these findings raise. Is it also true that college preparatory students are the ones least likely to become high school dropouts? We strongly suspect, though we cannot prove, that such is the case.

Table 4  
COLLEGE PLANS, COLLEGE ENTRANCE, AND  
HIGH SCHOOL CURRICULUM

Proportion of 1965-1966 high school seniors planning on college by high school curriculum				Proportion of 1965-1966 high school graduates entering college, as of February 1967, by high school curriculum	
Coleman data		Census data		Census data	
College preparatory	Other programs	College preparatory	Other programs	College preparatory	Other programs
(per cent)		(per cent)		(per cent)	
90	46	90	47	78	22
Ratio college entrants to college planners* by high school curriculum					
Census data					
		College preparatory	Other programs		
		.87	.47		

Also, since our data cover simply the academic year immediately following high school graduation, we cannot determine the high school curriculum for the approximately one in three of college entrants who enter more than a year following high school graduation. We have no reason to suspect, however, any substantial departure from the earlier strong relationship between college entrance and a college preparatory curriculum.

Before turning to the question of factors related to entering a college preparatory curriculum in high school, we wish to present some further insights into relationships between college plans, college entrance, and high school curriculum which the Coleman and Census data afford us:

\* This is not precisely a measure of proportions of college planners who in fact entered college, since a small proportion of the entrants (about one in nine) had been non-planners.

The two 1965 surveys, asking very similar questions on college planning, produced nearly identical proportions when college plans were cross-tabulated with high school curriculum. College preparatory seniors were nearly twice as likely as seniors in other programs to plan on college. But the Census followup of the seniors indicates that this gap widened when seniors attempted to put their plans into action the following year. College preparatory graduates were about three and a half times as likely to enter college as non-college preparatory graduates.

The Coleman study affords us some information on why this gap widened when intentions were translated into performance, as shown in Table 5.

Table 5

## RACE AND HIGH SCHOOL CURRICULUM OF HIGH SCHOOL SENIORS

Definiteness of plans of seniors planning on college	White		Non-white	
	College preparatory (per cent)	Other programs (per cent)	College preparatory (per cent)	Other programs (per cent)
College "probably"	24	61	35	63
College "definitely"	76	39	65	37
All planners	100	100	100	100

Whatever the racial group, the majority of college preparatory seniors planning on college had firm plans, whereas the majority of seniors in other high school programs had tentative ones. For the latter group, perhaps the personal commitment to higher education was weaker, perhaps the students were aware of objective obstacles to college entrance (such as fewer colleges which would accept them), or perhaps both of these factors were relevant.

The evidence, direct and inferential, seems to support one conclusion—that the overwhelming majority of college preparatory students eventually go to college and that most enter senior colleges but that only a minority of students in other programs enter college, and of those who do over half enter 2-year "open door" colleges.

What then are the major determinants of entering the college preparatory curriculum, and at what point is this decision made?

## V

## When is the High School Curriculum Selected?

IT IS IMPOSSIBLE to determine from available data precisely at what point a child decides to enter a college preparatory program, or even the extent

to which the decision is his to make. There is evidence that for many children, principally upper socio-economic ones, going to college (and consequently preparing for college) is simply taken for granted at a very early age. It is also clear that parents, children, and guidance personnel all participate in the high school curriculum decision. Guidance counselors in high school apparently conduct their "talent searches" not only in terms of test-score performance (representing ranking according to national norms), classroom performance (representing relative standing in a particular school), and socio-economic class (representing family educational support, both monetary and attitudinal), but also in terms of the student's personality (representing motivation, maturity, personal presentation, and behavior). If the student's academic self-image should prove a strong determinant of the curriculum selected, we should remember that this variable stands for complex interactions between child, parents, classmates, teachers, and counselors—and very possibly the child's siblings, or the absence of siblings, as well.<sup>6</sup>

But it is the association *per se* between relative self-image and curriculum choice that concerns us here, rather than the question of when and how that image is arrived at, or who mediates in the curriculum decision. The time of the curriculum decision itself may be approximately determined, and the factors which make it a decision difficult to reverse are quite clear.

Many high schools contact elementary school pupils who expect to enter the high school the following year, acquaint them with the available curricula, and request a choice by the student after consultation with his parents. The choice is often made during the Spring semester preceding high school entrance. In schools which do not contact prospective entrants, curricular choice is normally made early in the student's freshman year. The high school guidance counselor usually has the option of approving or disapproving the program choice, in whole or in part, basing

<sup>6</sup> There is the interesting possibility of a relationship between birth-order, achievement and a high level of self-esteem. National Merit Scholarship Corporation Research has consistently found that Merit Scholars tend to be first-born or only children, that second-born children are over-represented compared to third-born ones, and that the greater the age interval between a student and the next younger sibling, the higher the older child's academic performance. Since earlier and first-born children perform better on the tests that determine Merit Scholarship status than do the later-born, the effect would not appear to be attributable to a demographic artifact, but rather to stem from early environmental influences. It is also true that the Merit Scholars are characterized as aggressive, determined, and individualistic persons, presumably the sort of personality likely to form relatively favorable self-images. See R. C. Nichols, *The Origin and Development of Talent*, National Merit Scholarship Corporation, Research Report, Vol. 2, No. 10 (1966), Evanston, Ill.

this decision on the child's academic records, communications from teachers, and personal interviews with the child and his parents. The course selected is almost always entered at the start of high school for two reasons: first, it requires virtually the full four years to cover course requirements for acceptance at reasonably selective colleges; second, taking more advanced college preparatory courses later in high school (advanced math, for example) is not permitted unless less advanced college preparatory courses (freshman algebra, for example) have already been completed. In consequence, a pupil who wishes to switch from a non-college preparatory program to a college preparatory one faces the dual obstacles of completing a large number of required courses in a brief time, and of entering advanced courses while lacking the requisite prior credits.

In brief, somewhere around their 14th or 15th years, most children make a specific long-term academic commitment which is seldom reversed.<sup>7</sup>

## VI

### Who are the College Preparatory Students?

THE APPENDED TABLES A AND B present the relationships between students' estimates of their relative brightness and the high school course of study for racial majority and minority group high school seniors, controlling respectively for the senior's verbal ability and the educational attainment of the mother. Of all available socio-economic measures, parental education presumably best reflects the educational tradition in the home. The mother's rather than the father's educational attainment was selected because a large proportion of non-White students did not know the father's level of schooling, whereas the great majority knew that of the mother. Minority group seniors include Negro Americans, Puerto Rican Americans, Mexican Americans, and Indian Americans. Majority group seniors include not only White Americans but Oriental Americans,

<sup>7</sup> An extended treatment of the topics discussed in this section appears in: A. V. Cicourel, and J. I. Kitsuse, *The Educational Decision Makers*, in the Advanced Studies in Sociology series (Indianapolis, Ind.: Bobbs Merrill Company, 1963). This volume reports findings from interviews with parents, students, counselors, and social workers associated with a single large public high school. No claim is made for the representativeness of this high school for such variables as student socio-economic status, proportions entering college, etc. Rather a school was chosen "that incorporates the most advanced developments in educational theory and practice . . . most American high schools have similar bureaucratic structures and organizational practices, so that the kinds of decisions that are made at Lakeshore High are likely to appear with increasing frequency in schools around the country. . . . The differentiation of students . . . probably resembles that made in less 'advanced' high schools, but the decisions (and the criteria employed in making them) that produce the differentiation are more important at Lakeshore High because of the strong emphasis placed not only upon going to college but upon attending one of a select group of 'good' colleges" (pp. 23-24).

since both the Coleman report and recent Census data indicate that Oriental Americans differ markedly from other racial minorities, but closely resemble the White majority, for a multitude of significant educational variables.<sup>8</sup>

Verbal ability measures performance on an objective test consisting of "verbal items from the School and College Ability Test of the Educational Testing Service [SCAT] very close to the [College] Board's SAT [Scholastic Aptitude Test]." The test is designed to measure performance relative to all persons so tested nationally, and is also designed to reflect the individual's total learning experience (plus innate ability), rather than formal courses of schooling *per se*.<sup>9</sup>

The seniors were asked the single question: "How bright do you think you are in comparison with the other students in your grade?"

Let us summarize the findings, considering Table A first:

1. For minority and majority group students alike, both verbal ability and relative brightness are strong independent indicators of the high school course a senior has pursued. The higher the verbal ability, or the higher the estimate of relative brightness, the more likely it is that the senior has followed the college preparatory curriculum.
2. The independent relationships between each of the two academic measures and the high school curriculum are of roughly the same order of magnitude. Verbal ability (an academic measure independent of the ability of a student's classmates) and relative brightness (presumably a measure of the strength of the local competition), though mutually and positively related, nevertheless have about equal independent force in placing students on differing educational paths early in high school.
3. Whatever the racial group, and at every verbal ability level, relative brightness *strongly* influences curriculum choice. For minority group students this influence is most significant at low and medium verbal ability levels, since such students comprises about nine in ten of all minority group students. For majority group students it is the influence at the medium and high verbal ability levels that matters most.
4. Since far larger proportions of minority than of majority group seniors are of low verbal ability (the students least likely to enter college preparatory programs), minority group students as a whole are far less likely than majority group ones to enter such programs.

<sup>8</sup> See: Coleman et al., *op. cit.*; see also "Educational Attainment: March 1967," Bureau of the Census, *Current Population Reports*, Series P-20, No. 169 (February 1968), Figure 3, p. 3 and text commentary on p. 3.

<sup>9</sup> Kendrick, *op. cit.*, p. 8.

5. At each verbal ability level, however, there is little racial difference in proportions in college preparatory programs, and only a moderate difference in the relationships between relative brightness and the program entered. In general, relative brightness seems a slightly stronger determinant of curriculum choice for the majority students.

These, then, are the major relationships which emerge. But it is important to determine just how strong the relationships are in a statistical sense. Let us consider a few examples of the independent influence of estimated relative brightness upon curriculum choice—instances where sufficient numbers of students are involved so that the relationships are of practical, as well as theoretical, significance.

About nine in twenty majority group students are of medium verbal ability, and another nine in twenty of high verbal ability. Medium ability students who consider themselves "above average" or "among the brightest" in their classes (about a third of this verbal ability group), are about as likely to have taken college preparatory courses as high ability students who consider themselves simply "average" or "below average" (just over a quarter of this ability group).

Presumably virtually all high verbal ability students have college potential. However, of these able majority group students less than half who ranked themselves as "average" or "below average" entered college preparatory courses, whereas three quarters of the "above average," and nearly nine in ten of those "among the brightest" (just over one in five of the high verbal ability group), prepared for college. Similar though slightly weaker relationships may be cited for minority group seniors.

The findings which emerge from Table B, where the control variable is the education of the student's mother, parallel those we have described in Table A—with the qualification that the independent relationship between the mother's schooling and the senior's course of study appears somewhat less than between the senior's verbal ability and the course of study. But the important point is that though parental education and the student's academic self-image are considerably and positively related to each other, the self-image has a strong independent relationship to the high school curriculum at all levels of parental education and for both racial groups. Let us illustrate these generalizations with three specific examples from the tabulation.

About two-thirds of the minority group students had mothers who failed to graduate from high school. Of this group, students who felt they were "above average" or "among the brightest" (about four in ten of the group, excepting the small number of "don't knows") were about twice as likely

to have taken college preparatory courses as students who felt they were "average" or "below average." This finding repeats itself for majority group seniors with mothers who had completed high school, the model majority parental education group (about 45 per cent of the total cases). For majority group seniors with mothers who failed to graduate from high school (about 39 per cent of the cases) the relationship is strongest. The students with favorable academic self-images relative to classmates are about three times as likely to have taken the college preparatory curriculum as those with unfavorable self-images. If we compare the two extremes of the four academic self-image answer categories, rather than simply dichotomizing the responses, the differences we find are considerably greater. Though the extreme groups tend to be relatively small, they nevertheless indicate that the relationship between relative academic self-image and high school curriculum is a consistent one throughout.

Tables A and B present the two control tables one at a time. These two variables are considerably correlated but they are far from perfectly related; they cannot completely stand for each other. This is shown in Table 6.

Table 6  
Majority Group Senior's Verbal Ability

Mother's education	Low		Medium		High	
	No.	%	No.	%	No.	%
Under 12 grades	3,572	62	13,273	47	7,705	27
12 grades	1,805	32	12,194	43	14,199	50
13 grades or more	339	6	2,989	10	6,683	23
All educational levels	5,716	100	28,456	100	28,587	100

It could be argued that for either Table A or Table B it is largely the influence of the missing control variable which explains the apparent relationship between relative academic self-image and the curriculum followed. We tested this hypothesis by cross-tabulating high school curriculum and academic self-image while controlling for verbal ability and mother's educational attainment simultaneously. Let us summarize what we found.

For both racial groups, and for all ability-parental-education sub-tables, there is a strong relationship between self-image and curriculum choice, quite independent from the control variables in combination. Once again let us present several examples, deriving them from sub-tables with large numbers of cases.

For majority group seniors of medium verbal ability with high school

graduate mothers (about one in five of all majority group seniors), about a third had taken a college preparatory course. Of those with a more favorable academic self-image the proportion was a half—of those with a less favorable academic self-image, about a quarter. Of minority group seniors with low verbal ability and mothers who had failed to graduate from high school (over one in three of all minority group seniors), just over one in eight had taken a college preparatory course. Of those with a more favorable self-image the proportion was just under one in five—of those with a less favorable self-image, about one in ten.

The four-variable tables we have just discussed permitted us tentatively to rank the three independent variables for the extent of their relationship to the dependent variable, the high school curriculum. We realize that the indicators used may not have precisely or fully explored the relevant dimensions. A measure of academic capability other than verbal ability, for example, might be somewhat more, or somewhat less, related to curriculum choice. Bearing such possibilities in mind, we simply observe that verbal ability appears to be the best predictor of the curriculum, but that relative academic self-image is very nearly as strong. Parental educational attainment is a far weaker predictor than either of the other two. Each of the three, however, has sufficient independent significance to merit inclusion in any prediction equation of the high school course of study.

## VII

### *Ability Level and Class Rank Relationships*

THE SIGNIFICANCE of the relationships we have presented would be far clearer if we were able to determine the extent of association between ability level and class rank. We would have empirical evidence of the likelihood of academic situations which could lead to the operation of relative deprivation theory. Moreover, if there should prove to be considerable discontinuity between ability level and class rank, we would have additional (though still inferential) reason to believe that the student's academic self-image is as much based on his class rank as on his objective talent and achievement. We present in Table 7 the essential data on ability-rank relationships from a 1958 Office of Education study of high school graduates. (For simplicity we have recalculated, removing the one to two per cent n.a.'s from each line of the table)<sup>10</sup>

<sup>10</sup> Edith S. Greer and Richard M. Harbeck, *What High School Pupils Study*, U. S. Office of Education, OE-33025, Bulletin 1962, No. 10 (Washington, D.C.: U.S. Government Printing Office, 1962). See especially Table 7, p. 27 and summary of findings on page 65.

There is indeed considerable discontinuity between the two academic variables. Four in ten of the graduates in the upper quarter of the ability distribution were in the lower two-thirds of the class rank distribution. Over four in ten of the graduates in the lower quarter of the ability distribution were in the upper two thirds of the rank distribution. There is ample opportunity for many pupils to form erroneous estimates of their academic abilities, should they base them on class rank.

Furthermore, this study found that: "There was a closer relationship between credits earned (during the high school career) and class rank than between credits earned and ability level." Both high school curriculum, the dependent variable in our analysis, and credits earned, its counterpart in the OE study, presumably reflect educational aspiration; both would seem strongly related to the academic quality of the high school class relative to that of the individual pupil.

Table 7

PER CENT OF HIGH SCHOOL GRADUATES IN EACH ABILITY  
LEVEL BY CLASS RANK: CONTINENTAL UNITED STATES, 1958

Pupil ability level	Total %	Per cent of graduates by class rank		
		Upper third %	Middle third %	Lower third %
All pupils	100	39	34	27
Upper quarter	100	60	28	12
Middle half	100	29	40	30
Lower quarter	100	10	35	55

NOTE: For "all pupils" the class rank distribution does not represent precise thirds, since high school graduates are an academically selective group within the high school population.

## VIII

## Summary of Findings

LET US BRIEFLY RECAPITULATE the major findings:

1. The high school curriculum a student follows is entered at the start of a student's high school career.
2. There are strong barriers to switching to a college preparatory program from a non-college preparatory one. Few students make this change.
3. Few students in non-preparatory programs enter college and of those who do, the majority enter 2-year colleges, with all that this may imply for the duration and content of their higher educational experience.
4. Entering a college preparatory curriculum is very nearly as closely

related to a student's favorable estimate of his brightness, relative to his classmates, as it is to his objective performance on academic tests. Relative brightness is considerably more strongly related to curriculum choice than is parental educational attainment.

5. Empirically, there are large discontinuities between pupil ability and pupil rank in high school class; these should lead to erroneous academic self-assessments to the extent that class rank is the pupil's measure of personal ability.

6. Academic self-image, in sum, ranks as a major determinant of high school curriculum, and consequently of college entrance and the kind of college entered.

## IX

### The Implications of the Findings

THOUGH WE ARE NOT SURE to what extent a student's estimate of his relative brightness reflects his personal self-esteem, as well as his actual intellectual status in class, nevertheless it seems clear that many able students fail to enter college preparatory courses because of association with even more able students. Conversely, many students with rather modest abilities appear likely to enter college preparatory programs if their classmates are even less able than they. Further research on the validity of the student's academic self images, and the manner in which students arrive at these images (the role of parents, teachers, and guidance personnel, in addition to classmates and siblings), would be required if the full significance of our limited findings were to be determined.

Nevertheless, we feel that the findings cast considerable doubt on the popular assumption that the best high school for all students is one with superior students, as well as other academic excellences. Much recent research (most notably the Coleman study and subsequent analyses based on the Coleman data) has attempted to prove that lower socio-economic and racial minority group students, who generally rank low on national test-score distributions, show substantial academic improvement if they associate with upper socio-economic majority group students in classrooms. The evidence to this effect is not too convincing<sup>11</sup> and our data further

<sup>11</sup> In addition to the Coleman study (*op. cit.*), see especially: *Racial Segregation in the Public Schools*, Vol. I, *Report of the U.S. Commission on Civil Rights*, (Washington, D.C.: U.S. Government Printing Office, 1967). The major lacunae in this latter study are adequate measures of socio-economic status. For individual students and school populations alike, parental education is the sole yardstick. Since average family income differs greatly between Whites and non-Whites at each and every parental educational level, parental educational attainment is an inadequate socio-economic control for inter-racial comparisons:

suggest that the academic gains, if indeed there are such, should be balanced against probable losses in level of aspiration, and consequently in educational attainment.

From a more theoretical point of view, our findings suggest that the "contest mobility" which sociologists such as Ralph Turner have posited as a distinctive feature of the American public schools (as contrasted with the "sponsored mobility" which this scholar attributes to the British system) is subject to considerable qualification. In several ways the "contest" is not as "open" as it at first appears to be. Cicourel and Kitsuse have questioned this "openness" on the grounds that high school counseling personnel often influence a student to enter a particular curriculum on criteria other than the student's ability (social class, personal presentation, "right attitudes," etc.).<sup>12</sup> Our data suggest a further qualification. (In this context the prize contested for is extended quality education beyond high school.) It would seem that many students enter or decline the contest unrealistically, opting for the college preparatory curriculum or not according to the competition they face in the particular schools they attend.

Perhaps the curriculum decision is made too early and is too binding a one. Perhaps, even if the decision were postponed, students would persist in forming their evaluations of self by comparisons with classmates. Davis's data indicate that such is the case for college students, who should have somewhat broader academic horizons than those of 14- or 15-year-olds. Very possibly concerted efforts should be made to acquaint students

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MEDIAN YEARLY INCOME OF FAMILIES BY EDUCATIONAL ATTAINMENT  
OF HEAD OF HOUSEHOLD AND BY COLOR OF HEAD, 1965

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Years of schooling completed by head	(A)	(B)	Difference	B ÷ A
	White	Non-white		
	\$	\$	\$	%
Less than 8 years	4,001	2,839	1,162	71
8 years	5,602	3,896	1,706	70
9-11 years	6,861	3,951	2,910	58
12 years	7,605	5,621	1,984	74
13-15 years	8,547	6,294	2,253	74
16 years or more	11,075	9,084	1,991	82

SOURCE: *Statistical Abstract of the United States*, 1967, Table No. 477, p. 336.

The apparent findings of the study may simply be the effects of hidden economic differences. One effect could be a relatively high level of affluence, and hence of per-pupil educational expenditure, in locales where non-White pupils attend schools enrolling large proportions of White students.

<sup>12</sup> Cicourel and Kitsuse, *op. cit.*; see especially the discussion of Turner's thesis, pp. 134-138.

(and their parents) with their actual potential for higher education, based on national academic standing—and very probably such efforts should be made prior to the choice of the high school program. Furthermore, it well may be that counseling personnel, advising for or against the college preparatory program, in considerable measure base their advice, as the students base their self-evaluations, on the level of talent at the schools where they work.

Two decades ago, in 1947, just under three in twenty of the 25–29 year age cohort had completed a year or more of college; about seven in twenty had completed high school, and the remaining ten in twenty were about evenly divided between persons with one to three years of secondary schooling and persons who had never entered high school. Completion of high school at that time placed an individual in a relatively favorable academic position. For most persons, the high school course of study was not too significant, since all curricula could lead to high school graduation, the educational “rite of passage” that mattered most.

All high school curricula, however, do not lead to college, and today college attendance appears to have replaced high school graduation as the passport to better opportunities in later life. In 1967 almost six in twenty of the 25–29 year age cohort had completed a year or more of college (twice the 1947 proportion); nine in twenty had graduated from the 12th grade, and only about five in twenty had received eleven years or less schooling. There is evidence that even larger proportions of younger age cohorts have entered college in recent years. Nearly seven in twenty of all persons 20–24 years of age in 1967 had completed a year or more of college, and to this proportion must be added an unknown number of late entrants to college, plus students still in their freshman year (the data were collected in March).<sup>13</sup>

It is in this context of steady escalation of educational attainment that the choice of high school curriculum, and the determinants of that choice, assume critical importance. For the variable we have focused on in this article, the high school student's relative academic self-assessment, considerable further research would seem to be in order. It is the least understood, because the least investigated, of the major determinants of curricular choice.

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<sup>13</sup> The historical statistics derive from an unpublished age-cohort analysis by the present author of Census Bureau educational attainment statistics; see also, *Educational Attainment*, March 1967, op. cit.

## Statistical Appendix

Table A

CURRICULUM OF HIGH SCHOOL SENIOR BY LEVEL OF VERBAL ABILITY  
AND ESTIMATE OF OWN BRIGHTNESS RELATIVE TO CLASSMATES

Senior's verbal ability and high school curriculum	Minority Group Seniors Senior's estimate of relative brightness					
	Total	Below average	Average	Above average	Among brightest	Don't know
<i>Low ability</i>						
No. reporting	14,631	815	7,776	3,096	1,418	1,526
Total	100	100	100	100	100	100
College prep.	15	8	12	20	22	13
General	25	32	27	23	23	24
Other courses	60	60	61	57	55	63
<i>Medium ability</i>						
No. reporting	12,386	367	6,095	3,663	1,605	656
Total	100	100	100	100	100	100
College prep.	35	17	29	44	44	29
General	26	35	27	21	27	30
Other courses	39	48	44	35	29	41
<i>High ability</i>						
No. reporting	3,091	78	756	1,369	792	96
Total	100	100	100	100	100	100
College prep.	67	29	55	73	73	61
General	16	27	21	14	12	17
Other courses	17	44	24	13	15	22
<i>All ability levels</i>						
No. reporting	30,108	1,260	14,627	8,128	3,815	2,278
Total	100	100	100	100	100	100
College prep.	28	12	21	40	42	19
General	25	33	27	20	22	26
Other courses	47	55	52	40	36	55

Majority Group Seniors  
Senior's estimate of relative brightness

Senior's verbal ability and high school curriculum	Total	Below average	Average	Above average	Among brightest	Don't know
<i>Low ability</i>						
No. reporting	5,716	655	3,818	775	210	258
Total	100	100	100	100	100	100

Table A, Continued

College prep.	9	4	8	16	21	10
General	32	38	33	26	28	29
Other courses	59	58	59	58	51	61
<i>Medium ability</i>						
No. reporting	28,456	1,391	17,442	7,842	1,230	551
Total	100	100	100	100	100	100
College prep.	30	14	23	46	44	23
General	26	42	29	19	20	30
Other courses	44	44	48	35	36	47
<i>High ability</i>						
No. reporting	28,587	299	6,991	14,910	5,968	419
Total	100	100	100	100	100	100
College prep.	71	44	50	75	87	68
General	14	31	23	11	7	16
Other courses	15	25	27	14	6	16
<i>All ability levels</i>						
No. reporting	62,759	2,345	28,251	23,527	7,408	1,228
Total	100	100	100	100	100	100
College prep.	47	15	27	64	78	36
General	21	39	28	14	10	25
Other courses	32	46	45	22	12	39

SOURCE: Unpublished data from secondary analysis of the 12th grade computer tapes from the Office of Education *Equality of Educational Opportunity* study.

Table B

CURRICULUM OF HIGH SCHOOL SENIOR BY MOTHER'S EDUCATIONAL  
ATTAINMENT AND ESTIMATE OF OWN BRIGHTNESS  
RELATIVE TO CLASSMATES

Minority Group Seniors  
Senior's estimate of relative brightness

Mother's education and high school curriculum	Total	Below average	Average	Above average	Among brightest	Don't know
<i>Under 12 grades</i>						
No. reporting	19,859	947	10,124	4,843	2,332	1,613
Total	100	100	100	100	100	100
College prep.	22	10	17	31	34	15
General	26	34	28	23	24	25
Other courses	52	56	55	46	42	60
<i>12 grades</i>						
No. reporting	7,412	238	3,468	2,264	945	497
Total	100	100	100	100	100	100
College prep.	30	16	22	47	50	27

Table B, Continued

<i>13 grades or more</i>						
General	23	31	24	19	20	27
Other courses	41	51	48	34	30	46
No. reporting	2,837	75	1,035	1,021	538	168
Total	100	100	100	100	100	100
College prep.	53	24	42	63	63	42
General	17	23	21	13	16	23
Other courses	30	53	37	24	21	35
<i>All educational levels</i>						
No. reporting	30,108	1,260	14,627	8,128	3,815	2,278
Total	100	100	100	100	100	100
College prep.	28	12	21	40	42	19
General	25	33	27	20	22	26
Other courses	47	55	52	40	36	55

Majority Group Seniors  
Senior's estimate of relative brightness

Mother's education and high school curriculum	Total	Below average	Average	Above average	Among brightest	Don't know
<i>Under 12 grades</i>						
No. reporting	24,550	1,233	13,675	7,314	1,770	558
Total	100	100	100	100	100	100
College prep.	29	9	18	48	59	22
General	26	41	31	18	16	29
Other courses	45	50	51	34	25	49
<i>12 grades</i>						
No. reporting	28,198	908	11,964	11,527	3,315	484
Total	100	100	100	100	100	100
College prep.	52	18	34	67	80	43
General	19	38	26	13	9	22
Other courses	29	44	40	20	11	35
<i>13 grades or more</i>						
No. reporting	10,011	204	2,612	4,686	2,323	186
Total	100	100	100	100	100	100
College prep.	72	36	50	79	90	57
General	14	35	24	11	6	19
Other courses	14	29	26	10	4	24
<i>All educational levels</i>						
No. reporting	62,759	2,345	28,251	23,527	7,408	1,228
Total	100	100	100	100	100	100
College prep.	47	15	27	64	78	36
General	21	39	28	14	10	25
Other courses	32	46	45	22	12	39

SOURCE: *Ibid.*

## R E V I E W S

### The Eloquent Economic Philosopher

By STEVEN CORD

MANY COMPETENT BIOGRAPHERS have been attracted to the important and controversial career of Henry George. His son, Henry George Jr., was the first to publish (1900), and his biography is quite complete and thorough and still eminently worth reading. Filial piety there is aplenty, but it is easily discountable by the discerning reader. George Geiger's *Philosophy of Henry George* (1933) contains an admirable one chapter biography, and George's daughter, Anna George de Mille, published a delightful biography of her father in 1950, concentrating on the personal and anecdotal. Charles Albro Barker, in his scholarly and authoritative biography (1955) included some sources not available to George Jr. and was able to put the elder George's life into a broader historical context than his predecessors. Elwood P. Lawrence explicated George's great impact on the British Isles in a book published in 1957. There are other biographies worth noting, and now a new one<sup>1</sup> has appeared—this one in Twayne Publishers' United States Authors Series.

The biographer is Edward J. Rose, associate professor of English at the University of Alberta, Canada, who has also taught in the United States and has written numerous articles on Blake, Thoreau, Emerson, Melville and Shelley. He has produced a careful work which has taken full advantage of the very extensive Henry George Collection in the New York Public Library. Professor Rose concentrates, but by no means exclusively, on George the eloquent writer and powerful speaker: "This book is intended for the general reader and also for the specialist in American literature whose knowledge of Henry George may be slight. I attempt an explanation and evaluation of George's ideas and theories while also demonstrating that he was a writer of considerable gifts. For these reasons and because George's work is largely unread today, I have quoted frequently from both his published and unpublished writings" (from the preface, p. 10).

The book is compact and could be used as supplementary reading in a college history or literature course. Rose tells his story competently and fairly and obviously has had first-hand contact with the primary and secondary sources. The only trouble is that Rose offers us little that has not

<sup>1</sup> *Henry George*. By Edward J. Rose. New York: Twayne Publishers, 1968, 176 pp., Biblio., Index, \$3.95.

been said before. His biographical statements can be found in the other already published biographies, perhaps because no new sources on George have been uncovered since Barker presented his work more than a decade ago. And as for an evaluation of George's economic thinking, Rose gives us very little.<sup>2</sup>

Of course, Rose has stressed George's literary contributions, but in this he was preceded by Albert Jay Nock's literary biography of George (1939), a work which is strikingly more incisive than Rose's effort, particularly about the sources of George's literary style. In addition, Nock wrote brilliantly, although his caustic libertarianism lurks behind every line, sometimes obscuring his announced subject and irritating the reader (in any case, Nock's book is now out of print).

Rose was wise to quote George so extensively—eloquence strikes the heart more forcibly when allowed to speak for itself rather than through interpreters. This is especially true in Rose's case, because although his book is readable, its style is not exceptional. If a book concerns itself with literary eloquence, then one hopes for eloquence in exposition. Unhappily most readers are likely to find little grace in Rose's writing. For instance, passages like these abound:

"Even using the fact that he was once a recipient of a complimentary copy of *Progress and Poverty* from the author, the Duke of Argyll was consistently ironic throughout his article" (p. 109).

"*The Irish Land Question* was often reviewed with *Progress and Poverty*. In George's support of the Land Nationalization movement in England and in his plans to 'start the revolution,' the smaller book functioned like a destroyer escort convoying a battleship of the line into a decisive engagement for the control of the economic seas over which the British Empire had ruled unchallenged by wandering Yankees demanding their 'inalienable rights'" (p. 92).

"By that time George's disappointment in the one Democratic president [Cleveland] who had broken the hold on the White House which the Republicans were to maintain from the end of the Civil War to the Bull Moose days was complete" (p. 128).

Too often quotations follow one another, pell mell, back to back.

Style, of course, is purely a matter of personal opinion and each reader must judge Rose's style for himself upon a direct reading, but as I see it,

<sup>2</sup> However, one welcome new contribution is a reprinting of Emma Lazarus's poem entitled "Progress and Poverty [After Reading Mr. Henry George's Book]." The poem originally appeared in the *New York Times*, Oct. 2, 1881, thus preceding Miss Lazarus's celebrated poem on the Statue of Liberty by two years. Though a rougher gem, it is strikingly similar in form and imagery.

Rose neglects to build up to dramatic crescendoes, nor does he elicit the full humor or pathos from his material. His account of George's jailing in Ireland, for instance, does not at all compare in interest to the accounts of George Jr., de Mille or Barker.

Despite these shortcomings, Rose's effort is a worthwhile addition to a Georgist bookshelf. It will be especially welcomed by those who want a briefer biography than either Barker's or George Jr.'s, and by those who want to see George through the eyes of a literary critic.

A need still exists for one more biography of George, even in the absence of new source material. It should be as brief as Rose's book but the style should be popular and imaginative, one that can transmit to this generation in terms it can understand all the scholarly research already published but residing in books with little popular appeal. It should stress George as economist and ethical philosopher, for after all these were his main roles, although it should transmit George's eloquent passion and conviction through a judicious use of quotations—Rose is right in saying that one cannot fully understand George's career if his eloquence is neglected.

Among other questions that such a work should deal with, these should figure prominently: How did his ideas accord with the spirit of the time—the 1880s—thus accounting for his meteoric rise to popularity? In what ways was his message increasingly out of tune with the spirit of ensuing decades, thus accounting for the decline in his popularity? Where does George fit into the liberal-conservative continuum? What is valid in his economic philosophy? What is valid in his ethical philosophy? (At least, what do those for and against his ideas have to say?)

Such a biography should be more contemporary than the work by Henry George Jr., less personal than Anna George de Mille's, less comprehensive than Charles A. Barker's scholarly effort, and less opinionated than Albert Jay Nock's work. In the meantime, many readers will find this conscientious biography by Edward Rose to be an adequate introduction to the life and ideas of Henry George.

*Indiana University of Pennsylvania*

### **The Process of Change**

*Cambios Sociales y Formas de Vida. Estudios de Sociologia.* (Social Change and Ways of Life: Studies in Sociology). By Salustiano del Campo. Barcelona, Spain; Caracas, Venezuela: Ediciones Ariel, 1968, 282 pp., biblio.

This work, a publication of the Department of Sociology of the University of Madrid, is by Professor del Campo, who holds the chair of sociology

there. The author, on the basis of wide acquaintance with the international literature of the relevant social sciences, analyzes the process of social change. He explains that he is not concerned with social change in general, nor even with the revolutionary mutations arising from social, economic or political influences. His focus is intentionally on a partial and progressive target. In accordance with the notion of Margaret Mead that much change recorded in conventional history manifests itself sporadically in the behavior of some individuals and only gradually does it consolidate or agglomerate into identifiable basic change, he seeks to identify the moments when the individual makes his election and chooses behavior which, when multiplied, becomes the pattern of change. And when this is understood with reference to many different facets of social life, it will be possible to improve the changes which occur. This theory he applies in several empirical investigations, of communications media, of the role of education in economic development, of an elite group of achievers, of physicians who face the problem of birth control and of migrants in Barcelona. The results, while no more compelling than sociological investigations normally are, indicate that this is a useful insight.

W.L.

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## Social Calculus, Profitability, and the Conduct of Public Corporations

By GEORGE C. MANIATIS\*

THE INSTITUTIONALIZATION of public enterprise makes necessary establishing a standard for appraising managerial efficiency in an objective and reliable manner. Various criteria for evaluating the efficiency of public management have been advanced which can be classified basically into two categories: a) *quantitative*, relying on the quantitative behavior of a single statistic (profitability, sales, etc.), and b) *qualitative*, based on comparisons of selected statistics either between the present and past performance of the undertaking or between the current performance of like enterprises. Contrary to the belief that managerial efficiency can be appraised only by *qualitative* tests, it is submitted that *profitability*—a quantitative standard—provides a workable and more dependable norm of efficiency.<sup>1</sup>

The application of the profitability standard presupposes registrable, or more specifically, pecuniary values. However, public corporations are frequently compelled to satisfy broader social ends, the financial impact of which, for a variety of reasons, is not reflected in the accounts of the corporation. Consideration of such extra-financial values poses the question whether the suggested profitability standard for appraising managerial efficiency breaks down when social calculus enters into the decision-making process.

\* I am indebted to P. D. Henderson and T. Ganiats for valuable criticism.

<sup>1</sup> For a taxonomy and critical review of the various standards that have been proposed see the author's "Quantitative vs. Qualitative Standards for Evaluating Managerial Efficiency in Public Undertakings," *Indian Economic Journal*, April-June 1967, pp. 576-89. The analysis assumes undertakings of an industrial or commercial character.

The following analysis, based on British experience, is an attempt to show that the interjection of a social calculus in the pricing of a product or service and in deciding the desirability of an investment project is not incompatible with the profitability test of efficiency (or financial calculus), provided that the directing authority makes good to the undertaking the monetary value of the extra-financial costs or benefits which accrue to society as a result of the social bias introduced into the decision-making process. It follows that the terms of reference and the conduct of the public corporation should in turn be shaped in the light of this outcome.

In essence then our exposition centers on the rather neglected micro-economic issue of ensuring the efficient management of the institutions that are counted upon to fulfill social ends external to the enterprise. The importance of this matter is self-evident.

## I

## The Case for the Profitability Criterion

BEFORE PROCEEDING to examine our theme, it is worth setting forth the reasons for regarding the profitability criterion as the most *expedient* standard for appraising managerial efficiency. As already mentioned, qualitative standards entail a process of comparisons of selected statistics.<sup>2</sup> The improvement of specific indices over time or with reference to similar undertakings reflects the degree of efficiency achieved by the enterprise. Such comparisons, however, assuming that the construction of the requisite indices is possible, are of questionable usefulness. The unique conditions under which each undertaking operates render the suggested indices unusable for comparative evaluation.<sup>3</sup> To be sure, the study of such statistics provides valuable information. However, they can only serve as guides in forming a general impression of the enterprise's performance and as pointers for undertaking corrective action or improvement. Indices can be of very little help in appraising over-all managerial performance. The fact that each undertaking operates under its own particular circum-

<sup>2</sup> Cf. W. A. Robson, *Nationalized Industry and Public Ownership* (Toronto: University of Toronto Press, 1960), p. 431; A. H. Hanson, "Parliament and the Nationalized Industries," *Yorkshire Bulletin of Economic and Social Research*, September 1954, pp. 151-2; *Idem*, "Report on the Reports," *Public Administration*, Summer 1952, pp. 118, 121; R. Nottage, "Reporting to Parliament on the Nationalized Industries," *Public Administration*, Summer 1957, pp. 160 *et seq.*

<sup>3</sup> In point of fact, serious doubts have been expressed at times as to the validity of the conclusions arrived at on the basis of such comparisons. In one instance, Robson himself disagreed with the Select Committee's conclusions regarding the performance of the nationalized air corporations in England (*Report from the Select Committee on the Nationalized Industries: The Air Corporations*, H.M.S.O., London, May 1959, H.C. 213) and felt that their Report "cannot be regarded as an authoritative document." W. A. Robson, *op. cit.*, pp. 436-7.

stances during a given time span precludes comparisons with its own past performance<sup>4</sup> or the circumstantial current performance of similar enterprises. Sir Toby Low, a member of many Select Committees, describes as follows the difficulties the Committee encountered in passing on the performance of the major nationalized industries in England:

We quickly found that in the case of coal there was no yardstick by which we could easily judge the performance of the Coal Board. Comparisons made with the coal industry before nationalization or with foreign coal mines were of no value. When we came the following year to consider the performance of the nationalized air corporations, we found that it was possible to make certain useful comparisons with the performance of other airlines. But even then we had to be very careful; we had to make certain that we were comparing like with like. . . . When we came to British Railways we tried to find some useful statistics of continental and other railways which might help us to decide whether the British Railways could be more efficient, and if so, in what fields. But we quickly found here too that there was a danger of trying to compare like with unlike. Even the figures we mentioned of the time of wagon turnround are not wholly meaningful because of the different practices on the continent. However, some of these comparisons did help to point the finger at sensitive spots. A more useful comparison has been to compare the performance of these nationalized corporations in one year with their performances in previous years. But there is a limit even to the value of this type of comparison as a real test of efficiency.<sup>5</sup>

More illustrative is the following statement made by the Committee of Inquiry into the Aircraft Industry:

The Ministry of Aviation gave us comparative figures for the overall productivity of the aircraft industries of America, France, and Britain. . . . Direct comparisons are difficult to make and some of the data used by the Ministry, and the way they have interpreted them, are disputed by the Society of British Aerospace Companies.<sup>6</sup>

Aside from the above basic remarks, it should be noted that partial evaluations do not enable us to express an unequivocal opinion regarding over-all managerial efficiency. For instance, suppose the increase in labor productivity is judged "satisfactory," the load factor "poor," and some other index "bad." Obviously, evaluation in such a case becomes a

<sup>4</sup> M. Fleming, "Production and Price Policy in Public Enterprise," *Economica*, February 1950, p. 16.

<sup>5</sup> Sir Toby Low, "The Select Committee on Nationalized Industries," *Public Administration*, Spring, 1962, pp. 1-15, reprinted in A. H. Hanson (Ed.), *Nationalization* (Toronto: University of Toronto Press, 1963), p. 327.

<sup>6</sup> *Report of the Committee of Inquiry into the Aircraft Industry*, H.M.S.O., London, December 1965, *Cmnd.* 2853, paras. 419-20.

formidable task since weights have to be assigned to each index. Moreover, changes in productivity are not very meaningful by themselves as we cannot divorce changes in the productivity of one factor from those in the other cooperating factors. Also, changes in productivity are not meaningful without regard to changes in costs. Changes in costs, however, cannot be taken into account when indices are expressed in physical terms. Furthermore, the question arises as to what may be deemed a satisfactory improvement of the indices chosen. Finally, there is no reliable means for appraising management's effort to influence the firm's sales curve. All in all, when qualitative standards are applied, the subjective element looms large.

Admission of value judgments in assessing managerial efficiency leads to arbitrary and ambiguous inferences. The only convenient way to minimize such value judgments and ambivalences is to adopt a *quantitative* standard—preferably the *profitability* criterion.<sup>7</sup> Indeed, the profitability norm,<sup>8</sup> besides its unquestionable simplicity, is an objective and dependable test as it is based on the measurement of a one-dimensional effect encompassing the entire spectrum of the determinants of efficiency (e.g.

<sup>7</sup> Profitability implies maximizing the excess of revenues over costs in every identifiable line of production (or service) in the long run, consistent with operating at full practical capacity, and conditioned on specific, if any, constraints that may be set by the controlling authority (or statute). Cases are conceivable where the undertaking may have to minimize losses. *In addition*, the undertaking should be enjoined to apply standard cost accounting, such set standards being periodically revised. Profitability will serve as a guide both for investment and disinvestment. State interference for social reasons should be effected by means of subsidization. On the other hand, public undertakings must absorb any social costs arising from their operation to no less an extent that private firms do.

<sup>8</sup> Profitability in the public sector is *not* an end in itself. It rather serves as an incentive to greater efficiency and a yardstick for assessing performance. When applied in this sense, the allergic attitude toward profitability is no longer justified.

The profit maximization assumption has been questioned even in the private sector on grounds that it lacks realism. Instead, the 'social conscience' of the modern corporation and its at least partial substitution of public ends for private profit maximization have been stressed. Koplin has forcefully argued that there is no conflict between the profit maximization assumption and the businessman's desire for power, leisure, social prestige, security or any other non-monetary reward. Many activities which *prima facie* appear unrelated to profit maximization are on closer examination merely indirect approximations to profit maximization. Keeping prices unchanged in inflationary times may well be the essence of profit maximization, if long-term customers are thereby bound to the firm. Not charging the highest possible price to forestall entry clearly implies profit maximization in the long run. Keeping an employee on the payroll beyond his productive years may well pay for itself by the tacit promise of like treatment it holds out to younger workers. Sacrifice of immediate revenues, if a low-price policy will generate or preserve a valuable market position, means that profits may consist of increases in asset values including goodwill. Similarly, full-cost pricing, target-return pricing and sales maximization policies do not suggest failure of profit maximization but rather a search for convenient operating rules, especially in the face of incomplete knowledge. For a very interesting discussion on this matter see H. T. Koplin, "The Profit Maximization Assumption," *Oxford Economic Papers*, February 1963, pp. 130-9.



initiative, economy, organization, technique, adaptability, ingenuity, flexibility, etc.) Thus, it is divorced from value judgments and "educated guesses." More important, the profitability standard ensures a constant effort to reduce costs, since it provides the proper incentives to management to become enterprising and makes for continuing efficiency. The possibility of dismissal for inefficiency and the imposition of administrative methods of control and appointment are not as effective as the more automatic incentive to efficiency supplied by the need to produce an acceptable financial result.

The profitability standard, as reflecting also the impact of the demand schedule,<sup>9</sup> provides, in addition, a rough guide to consumer preferences. Alternatively, the particular circumstances which prevail and with which management has to cope can be taken into account in appraising its efficiency, as no recourse need be had to comparisons with the performance of like undertakings or the enterprise's past performance, which is the case when qualitative tests are applied. Moreover, profitability promotes managerial autonomy and makes possible the development of a potent *defense mechanism*, thus enhancing the resistance of the board to all sorts of political pressures, including the arbitrary interference of the minister in matters of day-to-day operation. Management is very likely to become more mindful, socially responsible and unyielding to outside pressures if it is supposed to produce an acceptable profit record and if its own position is at stake. The minister, on the other hand, will probably be far more restrained and less exacting on the board if he is forced to put in writing his directives and appropriate the necessary public funds to make up the amount lost by the enterprise, following his intervention. The desired balance of power between these two instrumentalities can best be maintained by developing a system of checks and balances rather than through legislative measures.

It should be mentioned in this context that outside interventions often foster mismanagement, as is particularly evident in less developed countries. And there seems to be much substance to the widely held opinion that public enterprises are inefficient and susceptible to political abuse.<sup>10</sup> Obviously such pronouncements reflect on the image of the institution and

<sup>9</sup> In particular, profitability makes possible consideration of the selling effort of management, for which standards cannot be set.

<sup>10</sup> In this context, Sir Toby Low has stated: "I say without fear of contradiction or need to produce specific evidence in support, that in these last ten years and before, the Chairmen of nationalized Boards have done things simply in order to please Ministers which they would not have done otherwise." (In "The Select Committee on Nationalized Industries," *Public Administration*, Spring 1962, pp. 1-15, reprinted in A. H. Hanson (ed.), *Nationalization*, *op. cit.*, p. 333).

cast doubts on its serviceability. On the other hand, it is the absence of effective competition in the public sector in many instances that commands a greater concern with internal efficiency. Loss of efficiency originating both in external and internal factors may well outweigh the alleged misallocation of resources due to deviations from the 'ideal' output, following the application of the profitability standard.<sup>11</sup> What is more, the profitability criterion ensures not only more efficient production of any given output, but also experimentation with new products, new techniques and new price policies. "In the direction of these latter aims, only limited results can be expected from external control agencies; among the various internal incentives that may promote them, the profit motive recommends itself as the only one which guides experimentation in precisely the directions indicated by the consumers' own market valuations."<sup>12</sup> In short, requiring management to adhere to a profitability standard keeps it on its toes.

One of the alleged weaknesses of the profitability test is the possibility of harboring managerial inefficiencies under the cover of monopolistically inflated revenues. It would appear, however, that this issue has been over-emphasized. In the first place, many monopolies in the public sector exist as such only in name as they are subject to inter-industry competition. Railways, for instance, compete with road services, airlines and ships; coal competes with electricity, gas and oil for most purposes. And where inter-industry competition is ineffective or nonexistent, it could be promoted. On occasion, exposure to foreign competition may be possible. Moreover, there are forces tending to dilute monopoly power, notably the process of technical change. Further, if competition is not effective due to restrictive practices, pertinent legislation can be enacted and enforced. Finally, if the undertaking does operate under monopoly conditions, prices can be fixed by the controlling authority. But even if prices are set for management, the contingency still remains that the cost figures produced may be inflated by the imputation of inefficiencies. By enjoining the undertaking to apply standard cost accounting and by revising periodically the set standard costs, inefficiencies can be detected and undesirable cross-subsidizations can be avoided.

In the light of the foregoing analysis, it is clear that the profitability standard satisfies a set of desiderata which typify a dependable and op-

<sup>11</sup> Although in practice the 'right' allocation of resources can never be discovered, and even in theory the concept is shaky. Cf. I. M. D. Little, *A Critique of Welfare Economics* (Oxford: Oxford University Press, 2nd ed., 1957), p. 193.

<sup>12</sup> L. Sheppard Keyes, "Some Controversial Aspects of the Public Corporation," *Political Science Quarterly*, 1955, pp. 46-7.

erational test of efficiency. The adoption of the profitability norm makes possible the assessment of managerial performance in a rather unequivocal manner, as the financial results can be rectified to take into consideration the imponderables demonstrably beyond managerial control. Thus, the accruing net result can conveniently serve as a success indicator. Indeed, the profitability criterion should appeal to *bona fide* management as it allows for ingenuity, imagination and all other managerial attributes that characterize a competent and efficient administration. Besides, the state can exercise *efficiency* control without resorting to a stultifying interference with the day-to-day business of the undertaking.

## II

### The Problem of a Social Calculus

BESIDES SERVING A SPECIFIC END (*e.g.* electricity generation), public undertakings are often used as an instrument to promote growth, combat regional unemployment, curb inflation, conserve on foreign exchange, and so on. This is usually done by influencing the criteria for undertaking an investment project, the means whereby a fixed end will be attained (*e.g.* use of domestic coal instead of imported oil for electricity generation despite its highest cost for the enterprise), prices, plant location, etc. The fact that such tasks are normally thrust upon the corporate entity poses the question whether the discharging of activities with a pronounced social bias lead to a breakdown of the profitability standard as a yardstick for assessing managerial efficiency. Indeed, the admission of non-pecuniary objectives into the decision-making process appears at first glance to militate against the application of the profitability test of efficiency. If the public corporation is to simulate the performance of its private counterpart, certainly it will shun the provision of unremunerative services or the undertaking of investments which are not self-liquidating or do not promise an adequate rate of return. This attitude, however, may be viewed as contrary to the public character of the corporation. Hence, the possibility of achieving both desiderata concurrently, *i.e.* provide social services and maintain an acceptable profit record as a gauge of managerial performance, becomes all-important. Obviously, the outcome has a bearing on the terms of reference and the conduct of public undertakings. The ensuing analysis is an attempt to examine the compatibility of these goals.

As already noted, a diversity of circumstances may give rise to a sharp divergence between the *economic* and the *financial* feasibility of an investment project, the former reflecting social considerations, the latter

portraying the actual outlays and revenues as recorded in the financial accounts of the enterprise.<sup>13</sup> In a particular scheme, it may be impracticable to identify and charge all beneficiaries in accordance with the benefits received. For example, investment in transport facilities may create time savings both to the users of the particular facilities constructed and to other modes of transport (*e.g.* by lessening congestion and speeding up traffic elsewhere in the transport system). Further, there may be economies on operating costs in other transport media (or to consumers of transport services), such as those deriving from the withdrawal of some of their equipment due to reduced traffic or better scheduling. Comfort and convenience, *e.g.* less standing at peak hours, increased probability of getting a seat, and the like, constitute another set of social benefits which may go wholly or partly unaccounted for.<sup>14</sup> Under the circumstances, the social gains from the investment undertaken cannot be measured by the private profitability of the project, since the latter normally accounts only for private costs and benefits. To a certain extent, however, social gains accruing to the direct beneficiaries of the scheme *can* be estimated by cost-benefit analysis<sup>15</sup>—admittedly not without difficulty—and either be properly charged and collected or, should this prove unworkable, they may be viewed as foregone revenue for the investing public enterprise. In the latter case, the State ought to make restitution of the revenue relinquished by the public undertaking and grant it a subsidy.

Social benefits accruing to the users of other modes of transport will have to be estimated roughly in any case, in order to determine the social desirability of the investment project in question. It should not be intractable to quantify these social gains, at least in a measure, and impute

<sup>13</sup> Financial feasibility conveys the self-liquidating character of an investment project, or the calculus of the private investor. Economic feasibility, on the other hand, reflects the social calculus that may enter into project evaluation and whereby the social desirability of the project is determined. In this sense, social costs and benefits may diverge from the actual monetary outlays and receipts. Hence, the distinguishing feature between financial and economic feasibility is that the latter includes social values which are not shown in the accounts of the investing agency.

<sup>14</sup> Cf. C. D. Foster and M. E. Beesley, "Estimating the Social Benefits of Constructing an Underground Railway in London," *Journal of the Royal Statistical Society*, Series A, 1963, pp. 51-5.

<sup>15</sup> J. R. Hicks, "Economic Theory and the Valuation of Consumers' Wants," *Journal of Business*, July 1962, p. 261. Hirschleifer *et al.* maintain that the extra-financial values of large water projects can at least be bracketed between certain limits. J. Hirschleifer, J. De Haven and J. Milliman, *Water Supply* (Chicago: University of Chicago Press, 1960), p. 125. Foster and Beesley have attempted to measure the surplus of social benefits over social costs expected to result from the investment in the new Victoria Line by the London Transport, *op. cit.*, pp. 46-78. Cf. also M. E. Beesley, "The Value of Time Spent in Travelling: Some New Evidence," *Economica*, May 1965, pp. 174-85; L. N. Moses and H. F. Williamson, Jr., "Value of Time, Choice of Mode and the Subsidy Issue in Urban Transportation," *Journal of Political Economy*, June 1963, pp. 247-64.

them to the stream of benefits. The creation of social benefits to indirect users invites the same treatment for the investing corporation as those accruing to direct users. In this way, while the social desirability of the investment to be undertaken can be decided by taking into account the net social benefits to accrue, it is also possible to ensure the financial feasibility of the project—a matter of cardinal importance to the enterprise—by properly compensating the latter.

Financial and social returns may further diverge because of a *deliberate* provision of services at a price which is much lower than the beneficiaries' willingness to pay, either to maintain price stability or on distributional grounds. The British Government, for instance, has been criticized for having exerted disproportionate pressure on the nationalized industries to hold their prices down in its effort to stabilize the economy. Such government interference, it is argued, has resulted in a significant decline in the profits of public undertakings and has created grave financial difficulties to a number of them. Besides, it has led to a transfer of income from the public sector to private industry, since the latter is a major consumer of the former's goods and services.<sup>16</sup> Not infrequently, the prices charged by the undertaking—yielding to irresponsible political pressures—are insufficient to cover the costs of the service supplied. Public corporations in many less developed countries fall into this category. The result has been a considerable deterioration of the quality of the service furnished. Again, social benefits of such a character can without difficulty be admitted to calculation and their imputed value be redressed to the public entity.

Often, the beneficial effects of an investment project on resource conservation, the strengthening of national security, the dispersion of industry, the creation of new investment opportunities, regional development, income redistribution, and the like, are strongly emphasized. It is even maintained that the community may wish to use one or more of these objectives as a criterion for project design, *i.e.* as one component of a complex objective function.<sup>17</sup> Past experience, however, suggests extreme caution. While there may be circumstances in which consideration of such intangibles<sup>18</sup> is valid, "they seldom have an important weight and

<sup>16</sup> J. Hughes, *Nationalized Industries in the Mixed Economy*, London, Fabian Tract 328, 1960, pp. 1-7.

<sup>17</sup> S. A. Marglin, "Objectives of Water-Resource Development: A General Statement," in A. Maass, M. M. Hufschmidt, R. Dorfman, H. A. Thomas, S. A. Marglin, G. Maskew Fair, *Design of Water-Resources Systems* (Cambridge, Massachusetts: Harvard University Press, 1962), pp. 17-8. Cf. also *Ibid.* pp. 65-7.

<sup>18</sup> For a possible treatment of intangibles see R. N. McKean, *Efficiency in Government through Systems Analysis* (New York: John Wiley & Sons, 1958), pp. 62-4. On the

usually are dragged in to serve the purpose of obscuring the real magnitudes of the costs and benefits."<sup>19</sup> An examination of the decision-making process would reveal that very rarely is the community adequately informed at the time the decision is made—let alone allowed to participate in the process.<sup>20</sup> Obviously, such an escape from public control may easily be abused. Democratic institutions, because of their imperfections, cannot safeguard against such improper practices. In a way, this is a penalty the society has to pay for relying on democratic processes to make decisions. As Jewkes has put it, "politicians do not usually give us much help in keeping economic costs in mind. It is no uncommon thing for governments, in the presentation of new schemes, to keep costs discreetly in the background or to present them at an optimistically low level or to dwarf their importance. . . . Cabinets will always be tempted to court popularity by giving way to democratic pressures for the provision of goods and services on exceptionally favorable terms or to uneconomic ends."<sup>21</sup>

Indeed, much of the pressure for federal participation in major public investment projects in the United States stems not from sound economic reasons but rather from special-interest groups who hope to gain from the provision of subsidized benefits.<sup>22</sup> In all, we should not lose sight of the fact that "just as the market can be rigged, the government can be manipulated to protect private interests of some constituents. Just as promoters can orient and stimulate the market, there is government bureaucracy which can gain from government activities."<sup>23</sup> Further, in countries with authoritarian regimes or somewhat lax political ethos and institutions, project-trading and reciprocity among colleagues can conveniently take place at the cabinet level. Once a cabinet agreement is reached, parliament can be swayed by virtue of the party discipline and the necessary support be mustered.

Notwithstanding the legitimacy of the admission of intangibles to decide the social desirability of a particular investment project, the fact

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other hand, the employment of otherwise unemployed labor on a public project implies that the *social opportunity cost* is zero and, as a result, their wage should be disregarded in the calculation of social costs. Such a treatment is fully justifiable in judging the *social* desirability of the project. Shadow prices reflect the real cost of the resources employed in the project to the society but *not* to the enterprise. In consequence, compensation of the latter is called for.

<sup>19</sup> Hirschleifer *et al.*, *op. cit.*, p. 132-7.

<sup>20</sup> *Ibid.*, p. 230.

<sup>21</sup> J. Jewkes, *Public and Private Enterprise* (London: Routledge and Kegan Paul, 1965), pp. 11, 24. See also *ibid.*, pp. 8-11, 14.

<sup>22</sup> J. Hirschleifer *et al.*, *loc. cit.*

<sup>23</sup> J. Margolis, "The Structure of Government and Public Investment," *American Economic Review*, Papers and Proceedings, May 1964, pp. 236-7.

remains that the net social benefits accrue to the society and not to the investing enterprise. The same is also true when social considerations affect the choice of inputs or the pricing policies of the public entity. If management is expected to run the undertaking efficiently and be in a position to show that it does so, it is essential that the balance between the economic and financial feasibility of any project be redressed to the enterprise.

Criteria for evaluating the social desirability of a public project cannot be relied upon to judge managerial performance. It may even be advisable in certain cases not to use the corporate form of public enterprise at all when launching such projects, as the attributes and functions of a corporate type of management probably are not needed in such schemes.

Besides, decision-making in public corporations is greatly facilitated if the government pursues projects specially designed to cope directly with such major social goals.<sup>24</sup> Instead, it may be appropriate to adopt a departmental form of organization. The corporate device should not be reduced to a surrogate for direct subsidies or to a convenient formula for political expediency. Although the equity capital of the corporation is public, the monitoring of the funds is clearly the responsibility of the management who, because of the public character of the enterprise, is more liable to irresponsible criticism.

It would appear then that a clear distinction should be made between the commercial and social elements of the corporate operations. The corporation should be entitled to recoup any extra costs or foregone revenues as a result of social considerations by direct compensation—by a direct subsidy. Direct subsidization, however, not only is politically opposed, but is also objected to on grounds that it might encourage managerial inefficiency, that the procedure does not distinguish between projects or operations that might have to be abandoned, and that collection of public money is not costless.<sup>25</sup>

None the less, recourse to disguised subsidies of elusive magnitudes, merely to achieve a social desideratum by more palatable means, should be equally resisted. Since the invocation of social objectives may easily lead to all sorts of abuses, it becomes imperative that unmindful political

<sup>24</sup> The Plowden Committee on the United Kingdom aircraft industry have expressed the view that regional employment should be promoted by general measures rather than by exercising bias in the selection of particular projects. "If the Government were to conclude that special assistance was justified to help employment in Northern Ireland, we believe this should be given by measures for promoting general economic development, rather than the aircraft activities of Shorts (Short Brothers & Harland)." H.M.S.O., *Report of the Committee of Inquiry into the Aircraft Industry*, December 1965, para. 449.

<sup>25</sup> See for example J. H. Williams, *op. cit.*, pp. 126, 127.

groups be brought to reason and discipline. One may even question whether the existing institutional and political arrangements are indeed valued as highly by the community as is often claimed. Further, by enjoining the public corporation to apply standard cost accounting and operations research it would not be difficult to eliminate inefficiencies and guard against cross-subsidizations. Finally, the "cost" of the subsidy may well be justifiable if corporate efficiency can be promoted.

Further shortcomings of a direct subsidy have been pointed out by Shepherd. He argues that there is little practical likelihood that a government will accept continuing direct subsidies, that past experience gives little hope that these subsidies would be "openly and rationally discussed," and that the way they would be calculated and reconciled with the accounts of the public corporations is not yet wholly clear.<sup>26</sup> There is no doubt that direct subsidies with the attendant publicity are politically opposed on obvious grounds. But this is not a sound reason for taking a fatalistic view of the matter and giving up efforts to press for open discussions and the adoption of straightforward solutions. Decision-makers should become more responsible and less evasive, and their propensity to make use of disguised subsidies whose magnitude is anybody's guess should be curbed. Significant progress in this direction can reasonably be expected, if public corporations assert themselves as truly autonomous entities. As to the alleged difficulties in computing the size of the subsidy, a fairly reliable estimate of the anticipated social benefits (and costs), as already noted, is in many instances feasible. On the other hand, the alleged difficulties in reconciling the subsidy with the accounts seem to be grossly exaggerated.

In the light of the preceding analysis, it can be argued that the conflict seemingly arising from the simultaneous pursuit of lucrative and social goals by a public corporation can be conveniently resolved, provided that the controlling authority is willing to go through the inconveniences (especially political) of imputing social benefits and of compensating the undertaking for benefits it renders to the community that go (wholly or partially) unpaid for. This implies in turn that the discharge of activities with a social bias in no way obstructs the application of the profitability standard for appraising the performance of public management.

### III

#### Multiplicity of Objectives and Managerial Conduct

THE INCIDENCE OF A MULTIPLICITY of objectives in pricing a product or service and, especially, in deciding the social desirability of a particular

<sup>26</sup> W. G. Shepherd, "Cross-Subsidizing and Allocation in Public Firms," *Oxford Economic Papers*, 1964, pp. 158-9.

investment plan obviously cannot be disregarded. In the latter case, the trade-offs between the set objectives should be established so that the socially most preferred choice is made. As far as public corporations are concerned, however, the existence of multiple objectives poses a problem regarding their conduct and terms of reference, in particular if profitability is the measure of their successful performance.

Public corporations are business ventures with definite objectives and *not* policy-making bodies. Management is expected to deploy its activities within a framework delimited *in advance* by the statute or by ministerial directives. The severance of managerial from general policy decisions requires as a matter of principle that the board should never be empowered or allow itself to be implicated in deciding what the public interest should be. In this case it is the board's bounden duty to take a "self-denying ordinance." Pronouncing on the public interest, which usually involves the reconciliation of partisan and antithetic views, entails value judgment and it is the minister's (and parliament's) prerogative to take the decision and direct the board accordingly.

Nevertheless, in many instances boards have developed a propensity for immersing themselves in matters of public interest.<sup>27</sup> Such tendencies are fostered by the absence of ministerial directions, the nebulous statutory delimitation of the scope of managerial jurisdiction or, occasionally, by statutory stipulations explicitly allowing for such decisions to be made. These circumstances tempt ambitious boards to attempt to acquire jurisdictions clearly outside their sphere of competence *in the name* of autonomy. Obviously, persistence of such conditions will inevitably perpetuate the bewildering current state of affairs.

Since the authority to cope with general-policy matters must unquestionably be vested in the government (and the parliament), the corporation should not, in principle, be concerned with the establishment of objectives and the formulation of broad policies, since this is done for it. However, this does not mean to imply that the board should be denied the capacity to advise. The accumulated knowledge and experience of the corporation may contribute in many ways to better project design and evaluation. More important perhaps, corporations could take the initiative and suggest to the parent minister the setting of novel targets and the under-

<sup>27</sup> The British Transport Commission "have from time to time themselves decided, without consulting the Minister, what it is that the public needs. . . ." *Report from the Select Committee on Nationalized Industries: British Railways*, H.M.S.O., London, July 1960, H.C. 254, para. 64. For a similar attitude of the other major nationalized industries in England see Francis Cassell, "The Pricing Policies of the Nationalized Industries," *Lloyds Bank Review*, October 1956, pp. 2-18; A. J. Merrett and Allen Sykes, "Financial Control of State Industry," *The Banker*, Part I, March 1962, p. 160; Sir Toby Low, "The Select Committee on Nationalized Industries," *loc. cit.*

taking of concrete projects to their fulfillment.<sup>28</sup> The important point, however, is that the board not implement any such objectives before they are sanctioned by the minister. The latter's approval becomes in effect a directive. On the other hand, the government may charge the corporation with the task of performing a service or undertaking an investment project which, on strictly commercial calculus, the board would never have initiated. The public character of the corporation suggests that the board in principle cannot refuse to carry out the directive. To avoid encroaching on managerial autonomy, however, the corporation must clearly be directed to this end and be reimbursed for the extra costs it will incur or the revenue it will forego.<sup>29</sup> The conduct of the financial affairs of the corporation is the management's responsibility and one of the dimensions of managerial autonomy.

#### IV

##### Concluding Remarks

THE UPSHOT of the foregoing analysis is that social considerations, which a public enterprise cannot usually shirk, present no serious problem and in no way impede the application of the profitability standard, on condition that provision is made for the imputation of their monetary values to the accounts of the investing agency—a process which in most cases is practicable. In this way, while the desirability of the specific service or investment project can be evaluated by taking into account direct and indirect social benefits, it is also possible to ensure concurrently the appraisal of managerial efficiency on the basis of the end financial results of the investing enterprise through proper compensation. Technically, this entails either an adjustment of the financial objectives of the public corporation<sup>30</sup> or, preferably, the granting of a direct subsidy. In the latter case, it is desirable that the subsidy be made explicit and open, so that who will be subsidized and who will pay are known to the decision-makers and to the

<sup>28</sup> More active participation of the board in public-oriented schemes could probably be ensured if they were certain that the pecuniary implications of such investments or unremunerative services would not be borne by the enterprise.

<sup>29</sup> The first evidence of an official acceptance of the compensatory principle can be found in the White Paper on *Transport Policy*, H.M.S.O., London, Cmd. 3057, July 1966, para. 141: "The Government will assume responsibility for the losses on services retained for social reasons, or on wider cost/benefit grounds, though the loss on such services which meet mainly local needs may ultimately be assumed by the local community. The Railways Board will then be given realistic financial objectives to assist them to move as soon as possible to a fully economic basis of operation." A similar treatment is provided for the case of uneconomic bus services.

<sup>30</sup> The fixing of specific financial objectives case by case is the official government policy in England since the early 1960's. See the White Paper on *The Financial and Economic Obligations of the Nationalized Industries*, H.M.S.O., London, Cmd. 1337, April 1961, especially para. 23.

electorate. It should perhaps be emphasized that the corporate form of public enterprise may not lend itself to public projects with strong distributional or other intangible biases and, in principle, it should not be used. Once such a project is undertaken, however, compensation of the corporate enterprise must ensue.

It may be worth stressing at this juncture that unless an attempt is made to specify and quantify, to the extent possible, the anticipated net social benefits from a specific project, there is grave danger that such prospective benefits may be grossly inflated. In this respect, it may be argued that the adoption of the profitability criterion forces the decision-making authority to undertake or approve of a cost-benefit study in each case and not to rely on vague qualitative judgments. It is very likely that a give and take will occur between the controlling authority and the public board in the process of enumerating and evaluating the prospective social costs and benefits, each party trying to strike the best deal for itself. Indeed, the former may try to exaggerate the pros and minimize the cons of the particular project, while the latter may try to do just the opposite. However, the end result of this exchange will be the airing of every single facet of the project and the most reasonable evaluation of the prospective benefits.<sup>31</sup>

Finally, the multiplicity of objectives, including profitability as a measure of successful managerial performance, in effect defines the basic terms of reference which should guide the conduct of the public corporation. They may be summed up as the pursuit of profitable operations given the constraints imposed by the statute or controlling authority, if any. Only the latter may decide and instruct the board when profitability is to be subordinated to other social goals—when a social calculus should be applied in the decision-making process. It is the responsibility of the management to decide on the *means* whereby the objectives set by the statutes or ministerial directives will be achieved. If the minister feels that different means should be employed for the attainment of a given end in the public interest, he should so direct the board, and the *fiscus* must assume the extra financial burden. In this way the board does not become the arbiter of the public interest, managerial performance can be assessed objectively, while the minister is compelled to issue a directive and assume the attendant responsibility of his actions.

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<sup>31</sup> Obviously this presupposes a considerable degree of independence of the board, which can be ensured only if the profitability test is applied. For a more detailed discussion of this matter see the author's: "Managerial Autonomy vs. State Control in Public Enterprise: Fact and Artifact," *Annals of Public and Cooperative Economy* (October-December, 1968), pp. 513-30.

### *Non-Conventional Food Sources*

ALTHOUGH THERE IS considerable discussion of non-conventional sources of food, the preponderance of evidence suggests that it is unrealistic to conclude that within a predictable period of time the world could depend largely upon non-conventional food resources. Rather, it might be expected that agriculture as we now know it will have to become increasingly efficient and automated, and that there may well be a growing shift away from animal production to the production of large quantities of plant foods that are consumed directly by man.

Many suggestions have been made as to how the sea could be made more productive and, to some extent at least, "farmed."

Attention has been called on many occasions to the vast quantities of proteins present in plant parts not ordinarily used for economic purposes. It has been clearly demonstrated that leaf proteins can be extracted, purified, and used both as animal food and as human food.

Microorganisms have long been a tantalizing possibility for increasing food supplies. Many in themselves have a high protein content and others lend themselves to chemical conversions.

The yeasts have long been known to be a potentially important source of protein. There is no question that, under appropriate culture conditions, they can be produced in vast quantities and then utilized either directly or as a supplement for the enrichment of a wide variety of foods.

The enormous variety of bacteria, and the multifarious biochemical transformations which they bring about, have often suggested the possibility of using them for the production of protein substances. We know that bacteria can convert mineral salts, natural gas, nitrogen, and carbon dioxide into protein, which can then be recovered in the form of dry bacterial cells.

However, the over-enthusiastic idea that conventional agriculture will be dispensed with in the foreseeable future is unrealistic, as is the notion that were unconventional food production to become successful, agricultural land would then revert to its natural sylvan state for the everlasting recreational enjoyment of man. Toward the conquest of hunger, as in so many vital challenges that face us, we must concentrate our best efforts on what is feasible today while vigorously seeking new possibilities for the future. [*From The President's Review.*]

J. GEORGE HARRAR

## The Issue-Analysis Approach to Community Power: A Case Study of Realtors in Kalamazoo\*

By DONALD H. BOUMA

**ABSTRACT.** Utilizing primarily the issue-analysis method and incidentally the reputational method an assessment is made of certain aspects of social power in a midwestern community. Although a housing proposal had the support of almost every organization in the community, voters rejected it because the real estate board was the key influential in the decision-making process. Respondents clearly saw a self-interest motivation on the part of the realtors but nonetheless identified with them. Neither Republicans nor Democrats voted in accordance with the recommendations of their organizations, church members rejected the advice of religious groups, and union members did not follow the urging of the unions. The validity of the reputational method of determining social power is questioned since respondents generally did not identify the real estate board as an influential group in determining community decisions.

THE SOCIAL POWER STRUCTURE of a community may be assessed either through the use of the reputational method or by utilizing the much more difficult issue-analysis method. The reputational method, developed by Floyd Hunter about a decade ago,<sup>1</sup> asks selected respondents to identify individuals or groups considered to have influence in the community.

The issue-analysis method involves the study of actual influence in deciding a concrete community issue. The value of the specific issue as a power-determining factor will depend on the intensity of public interest surrounding it, its controversial nature, and the degree of involvement and alignment of the constellation of community groups.

The reputational method has the advantage that it can be rather easily used at any time, in any community, involving any number of organizations and individuals, and covering any number of influence areas. Its defects have been widely discussed.<sup>2</sup> Chief among them is that one has

\* The research reported here was supported by a grant from the W. E. Upjohn Institute for Employment Research, Kalamazoo, Michigan.

<sup>1</sup> Floyd Hunter, *Community Power Structures* (Chapel Hill: University of North Carolina Press, 1953).

<sup>2</sup> An excellent discussion of this problem is found in "Research Reports and Notes," *American Sociological Review*, Vol. 27 (December, 1962), pp. 838-54, where separate contributions of Nelson W. Polsby and Raymond E. Wolfinger criticize the reputational technique, and a piece by William V. D'Antonio, Howard J. Ehrlich, and Eugene C.

no way of knowing whether the reputed power group does have actual influence in concrete situations.

The issue-analysis method has the advantage of actually determining effective social power. However, it has numerous difficulties. Issues generally cannot be devised, they just happen. This means that issues determine the timing, scope, locale, and, in a sense, the design of the research. This fireman role may have little appeal to the social researcher, but it is what happens at the fire that counts, not who wins the checker games at the engine house.

The present study used primarily the issue-analysis method with incidental utilization of the reputational method so that comparisons could be made. The situation analyzed was an election involving a controversial housing issue in Kalamazoo, a Michigan city of 82,000 population. The voters rejected by a 3-2 margin a housing proposal which had the publicized support of almost every organization and agency in the community. The situation was ideal for the study of social power in that the issue was clear-cut, it was controversial, it generated considerable public attention, and it involved practically every influence group in the community.

# I

THE HOUSING CONTROVERSY was one of those rapidly developing community issues, and involved the city in its most heated election in history, with a record voter turn-out. The seven-member city commission had received a report from its building and health officers which termed the housing situation critical. Recommended was a housing ordinance and housing commission as the most practical method of dealing with what was described as "the basic problem of bad housing for low income families." The ordinance establishing a five-member housing commission was adopted by a 6-1 vote of the city commission. It required the housing commission to investigate all possibilities of privately financed housing before seeking any kind of federal help.

The ordinance reached the ballot by referendum, called by virtue of

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Erickson defends it. See, also: Raymond E. Wolfinger, "Reputation and Reality in the Study of 'Community Power,'" *American Sociological Review*, Vol. 25 (October, 1960), pp. 636-44; Howard J. Ehrlich, "The Reputational Approach to the Study of Community Power," *American Sociological Review*, Vol. 26 (December, 1961), pp. 926-27; William V. D'Antonio and Eugene C. Erickson, "The Reputational Technique as a Measure of Community Power," *American Sociological Review*, Vol. 27 (June, 1962), pp. 362-76; Lawrence J. R. Herson, "In the Footsteps of Community Power," *American Political Science Review*, Vol. 55 (December, 1961), pp. 817-30; Nelson W. Polsby, "The Sociology of Community Power: A Reassessment," *Social Forces*, Vol. 37 (March, 1959), pp. 232-36.

petitions filed after a drive for signatures spearheaded by the Kalamazoo Board of Realtors. During the subsequent campaign the realtors continued to play the dominant role in the opposition. Theoretically, they were joined by several small groups, including the Retail Lumber Dealers Credit Association and the Home Builders Association, but these groups were practically never seen nor heard during the campaign.

Taking official stands in favor of the issue was a large array of business, political, civic, and social organizations, cutting across all sectors of the community. Included in the list were the County Council of Churches, as well as many individual congregations, League of Women Voters, Young Women's Christian Association board of directors, National Association for the Advancement of Colored People, County Council of Social Agencies, Downtown Kalamazoo Association (a strong organization of business men), Business and Professional Women's Club, Community Improvement Association, American Federation of Labor-Congress of Industrial Organizations (AFL-CIO) Labor Council, County Council on Human Relations, the city's only daily newspaper, County Nursing Council, and both the Republican and Democratic party organizations.

Proponents and opponents were both extremely active in the campaign, spending large amounts of money on every conceivable technique for influencing the voters. In spite of the lop-sided support, the housing proposal was voted down in 36 of the 44 precincts of the city.<sup>3</sup>

Because of the unusual factors present in the election, including the alignment and degree of involvement of community power groups, a study was designed to attempt to ascertain and assess some of the significant elements in this community decision-making process. The author, director of the study, had previously analyzed the basis for, and legitimation of, the dominant social power position of a real estate board in another Michigan city, Grand Rapids. In that city, also, the real estate interests had been successful in influencing community decisions even though opposed by a cross-sectional configuration of official and unofficial organizations.<sup>4</sup>

As a case study of the dynamics of the community decision-making process, the present study focused in particular on factors influencing

<sup>3</sup> For an account of the election campaign see Henry Upjohn and Evelyn Upjohn, "Kalamazoo Referendum Defeat: Victory for Real Estate Board Tactics," *Journal of Housing*, Vol. 18 (August-September, 1961), pp. 340-42.

<sup>4</sup> Donald H. Bouma, "Analysis of the Social Power Position of a Real Estate Board," *Social Problems*, Vol. 10 (Fall, 1962), pp. 121-32; and "The Legitimation of the Social Power Position of a Real Estate Board," *American Journal of Economics and Sociology*, Vol. 21 (October, 1962), pp. 383-92.

voter preference. It aimed to assess the effectiveness of various techniques used to help the voter make up his mind, and to determine to what extent variables such as education, income, occupation, age, sex, length of residence, religion, home ownership, and others, were related to the way people voted on the housing issue. It sought to determine the values which characterize the community and the factors influencing them. Of major importance was the way people perceived the interplay of community organizations and the relative effectiveness of various groups seeking to be influential in the making of an important community decision.

The study was concerned with whether the people accepted the definitions of the situation projected by the opposing power groups, and why the board of realtors was more successful than the array of 30 community groups in convincing the voters of the validity of its value system. A major interest was whether members of organizations tended to vote in accord with the public stand of their groups. That is, did union members vote as their union advised, church members as their churches advised, party members as their parties advised? Was it just a free-floating anxiety or confusion which caused people to vote no, or did they have rather fixed reasons? What reasons did people give for voting the way they did, and what reasons did they give for the way other people voted? Would the non-voters have changed the results of the election if they had voted? These concerns focused the inquiry.

Research methodology included interviews in 250 households drawn from the Kalamazoo Standard Sample which was devised by the Survey Research Center at the University of Michigan. The interviewers used a schedule containing 61 items calling for both structured and unstructured responses. Field interviewing was done within two weeks after the election so that the effects of the campaign could be assessed with a minimum of memory strain. A total of 244 usable interviews was obtained. The division of yes and no votes as well as the percentage voting were virtually the same for the respondents and the population, indicating the representativeness of the sample. In the election 40 per cent voted, while 45 per cent of the respondents said they did. In the election 59 per cent voted against the proposal, while 61 per cent of the respondents said they voted no.

## II

THERE ARE A NUMBER of possible explanations for voter disapproval of a proposal which had the endorsement of virtually every group in the community. Before one can move to the determination of social power

groups through issue-analysis, other factors must be considered which might have produced the observed result. This is particularly important when the situation involves the rejection of an issue, that is if there is any truth to the observation that people have a tendency to vote against proposals calling for a change.

Each issue, of course, has its unique set of complicating factors. In the Kalamazoo housing election there were six explanatory possibilities which had to be considered before an adequate appraisal of the role of influentials could be made.

First, the negative vote might have been the result of failure to see the need for doing something about the housing problem. This was not the case. The proponents stressed the need, the opponents conceded that the city had a serious housing problem, and 66 per cent of the respondents in the study said the city had a housing problem, while only 20 per cent denied this and 14 per cent did not know.

Second, the negative vote might be attributed to the fact that voters were confused by the issue, and it is an old political saw that "when confused, vote no." This was not the case. Although 41 per cent of the respondents reported that they were "somewhat confused" by the issue, compared with 34 per cent who said they "knew clearly how to vote," the percentage of yes votes among the former (40 per cent) was slightly higher than among the latter (37 per cent).

Third, a negative vote at times is explained in terms of the non-voter. Presumably, those opposed to an issue are more concerned to vote than those in favor of it. For example, it has been found that the higher the voting percentage on school bond issues, the greater the possibility of failure. This was not an adequate explanation in the Kalamazoo study. When non-voters were asked how they would have voted, 34 per cent said they would have voted yes, 26 per cent would have voted no, while 40 per cent did not know. Although the non-voters who had a preference would have given the housing proposal a 56 per cent yes vote, this would not have changed the results of the election. When voters were combined with non-voters who took a stand, the negative vote drops from 61 per cent to 54 per cent. When those with no opinion were allocated according to the same percentage as the yes and no stands of the other non-voters, the percentage of negative votes drops to 52. Hence, non-voters did not explain the outcome of the election. Additionally, it should be noted that the issue was a heated one which brought out the largest percentage of voters for a local election in the history of the city.

Fourth, a negative vote is often explained by the hesitancy of people

to vote tax increases. The housing proposal carried no provision for tax increases or expenditures of any kind. Any program which might have been recommended later calling for expenditures would have had to be the subject of another vote. The fact that the realtors said that taxes would increase and that many people believed this campaign gimmick is a separate issue to be discussed later.

Fifth, a negative vote might be the result of inadequate campaign efforts by the proponents. This was not the case. The proponents had sufficient financial resources so that all known campaign techniques could be utilized. An early start was made on the campaign and prestige people from a variety of interest areas contributed hours of time in the effort.

Sixth, immediately after the election many observers attributed the defeat to the conservatism of the Dutch ethnic group. Second and third generation Holland-Americans constitute one of the largest nationality segments in the community and have been a scapegoat for other defeated issues. Some support for this was found in the high negative vote (91 per cent) of Reformed and Christian Reformed church members, denominations made up primarily of Holland-Americans. However, this church group comprised only 10 per cent of the study sample. Further, a survey recently completed by the author, using the name-analysis method, indicated that Holland-Americans constitute only 20 per cent of the local population.

The voter study assessed the image people had of the size of the Holland-American group. Excluding those who did not venture an estimate, 43 per cent thought that half or more than half of the residents of the community were of Dutch descent, 16 per cent thought about 40 per cent were, 24 per cent said 30 per cent, 11 per cent said 20 per cent, and 7 per cent said 10 per cent or under. That almost 60 per cent of the respondents estimated the percentage at least twice as high as was actually the case again demonstrates the tendency for people to overestimate the size of a minority.

These six factors, then, do not adequately explain why the voters rejected a proposal which was vigorously endorsed by such a wide range of community organizations. Rather, the study revealed that the negative vote was the result of the highly-organized opposition of a vested interest group which was able to launch a campaign, the dimensions and content of which were largely determined by its parent organization outside of the community. The people voted no because the Board of Realtors told them to vote no, and largely for the reasons the realtors used in the campaign. They voted with the realtors and against the advice of groups of

which they were members. They voted with the realtors and contrary to their clear perception of the nature of the housing problem in the community. They voted with the realtors in spite of the fact that they recognized and admitted that the realtors had a selfish interest in a negative vote.

### III

WHETHER THE REALTORS shaped the values of the voters to produce a negative vote, or whether they simply tuned in on the value system of the community and articulated it, cannot be known. While it is impossible to rule out the latter as a conceivable alternative, it is quite unlikely that the other community groups, all supporting the proposal, would be that insensitive to dominant community values. Either way, whether through the shaping of values or the articulating of them, the realtors were able to influence the election outcome because of their position of social power.

The exercise of social power had high visibility. When asked to indicate which groups opposed the housing proposal, two-thirds of the respondents identified the realtors. Although some 30 groups were publicly on record as favoring the proposal, people were hard pressed to identify any of them, with 57 per cent saying they could not recall any. A partial explanation for this might be that many of the advertisements urging a yes vote bore only the name, "Action Committee for Kalamazoo Housing," an *ad hoc* group organized just for the campaign.

There was a clear recognition that a negative vote would serve the self interests of the realtors, although in all of the campaigning the realtors carefully avoided giving this impression. Realtor arguments for a negative vote revolved around three principal themes: Protecting the American way of life from the drift to socialism, higher taxes, and sparing the community the evils of public housing. However, when respondents were asked if they thought any group had something to gain for itself by the outcome of the election, 44 per cent of them said yes, 30 per cent no, and 26 per cent did not know. When those responding affirmatively were asked which group they had in mind, 55 per cent identified the realtors. Other groups received only scattered mention, the next highest being construction companies at 7 per cent.

When all respondents were asked directly if they thought the realtors had something to gain for themselves by a negative vote, 48 per cent agreed, 25 per cent disagreed, and 27 per cent did not know. Even those who thought the realtors had a selfish interest in the outcome voted with the realtors, producing a majority (56 per cent) of negative votes. This

indicates the measure of identification of the voters with the value system of the realtors. The voters did not choose between two vested interest positions, but rather clearly recognized the self-interest position of the realtors and accepted it, or recognized it as their own.

The community image of the motivating factors in the position of the realtors was probed through the use of an additional open-end question. When asked, "Why do you think the realtors opposed the housing issue?", 60 per cent thought it was because it would hurt the realtors' business or because of self-interest. Other than the 31 per cent who said they did not know, there was only scattered mention of other motivating possibilities. Again, there was not only a recognition of the self-interest position of the realtors, but an identification with it, as 58 per cent of those who said the realtors opposed the issue for business reasons voted with the realtors against the proposal. People did not perceive the realtors as fighting a battle to preserve important community values, but rather as fighting for their own best interests, and they approved of it.

The social influence of the real estate group was further demonstrated by the fact that people gave as reasons for their negative votes the same factors that were used by the realtors in the campaign. They said they voted no because people should help themselves (24 per cent), because taxes would increase (16 per cent), because it was not good for the city and another plan would be better (12 per cent), because it was socialistic (10 per cent), and for scattered other reasons. The fact that no one gave as an explanation for a no vote the stand of the realtors against it indicates that the values cited by the realtors in the campaign had become well internalized—or that the realtor values simply reflected and articulated dominant values in the community.

When questioned directly on whether they thought local taxes would increase if the housing issue passed, 50 per cent said yes, 30 per cent said no, and 20 per cent did not know. If the increase in local taxes as the result of the passage of the housing measure actually were a debatable issue, the 50-30 acceptance of the realtors' point of view would be a measure of the social power position. However, since higher taxes would not have followed passage of the proposal, which fact was repeatedly emphasized by the proponents, the success of the realtors in selling their theme of higher taxes is even more remarkable. There is nothing in the analysis of this decision-making process which more clearly demonstrates the effectiveness of the realtors' campaign and the strength of the power position.

The respondents also recognized this effectiveness. When asked which

of the various groups involved in the campaign was most effective in presenting its position, 70 per cent selected the real estate group. The city commission was picked by 13 per cent, 6 per cent said the churches, and the remainder were widely scattered.

#### IV

THE SOCIAL POWER POSITION of the real estate board was also indicated by the study finding that members of organizations failed to vote in accord with the publicized position and advice of the organizations. While voting patterns could not be linked with organizational affiliations of all respondents, the available data did indicate that neither Republicans nor Democrats voted in accordance with the recommendations of their parties, that church members rejected the advice of religious groups, and that union members did not follow the urging of unions. This may be the day of the "organization man," but the voting booth provides an opportunity for a declaration of independence.

In spite of repeated public endorsement by both the county Republican party and the county Democratic party, voters of neither party gave the housing proposal a favorable nod. A little over half of the Democrats voted no and close to 60 per cent of the Republicans did. Highest percentage of negative votes (68) came from those who claimed to be independents.

Protestant church groups were highly active during the campaign. The day before the election, which was Easter Sunday, church groups ran a two-page advertisement in the newspaper urging a yes vote for religious reasons. It was signed by the local ministerial alliance, the county council of churches, and individual protestant denominations. Even though the vote came at the high point of the church year, when religious influences could be assumed to be at their peak, the majority of voters allied themselves with the position of the realtors over against that of their church groups. Protestant church members produced only a 42 per cent favorable vote, practically the same as the city total. Catholic voters showed a 40 per cent favorable vote although no Catholic group took a public stand one way or the other during the campaign. It should be noted that "protestant" was not a residual category in the study, nor was it accepted as a general designation of religion. Respondents were asked to indicate the religious denomination they were a member of, if any. The "none" category included 18 per cent of the respondents. There was only one Jewish voter in the sample.

About 30 per cent of the respondents were from households in which

the chief wage earner was a union member. Although the Kalamazoo Labor Council, AFL-CIO, was one of the active supporters of the housing proposal, the study revealed that the negative vote among union members (68 per cent) was higher than for non-union members (59 per cent).

In spite of wide-spread community support, the housing proposal which developed such intense public attention was defeated because the realtors wanted it defeated and were successful in presenting a set of rationalizations for a negative vote acceptable to a majority of the voters. Among the influentials in the community, the realtors were in the key position of social power on this issue.

Although the issue-analysis method of determining social power was the primary technique used in the study, it was decided to make some use of the reputational method and attempt to determine the voter image of community influentials. Ideally, such an approach should have been used prior to the election and, better still, prior to the campaign. To use it immediately after the election could only load the responses in favor of the realtors. But the results were surprising and constitute a serious indictment of the reputational technique. Respondents were asked which of all the organizations in the city had the most influence on public issues. Only 7 per cent picked the realtors. Leading the list was the newspaper (27 per cent), followed closely by radio and television (25 per cent), then downtown businessmen (14 per cent), churches (11 per cent), Republican party (7 per cent), and unions (5 per cent).

Even though the realtors had just been recognized as powerfully effective in the housing election, defeating the combined forces of almost all other community groups, only a small percentage of the people perceived the realtors as having much community influence. One can only surmise how small the percentage would have been if the question had been asked prior to the housing election. On the other hand, the mass media and the businessmen's group were not said to be very influential in the concrete case of the housing election, but considerable credit was given them for influence in the abstract. There is no research evidence on the role played by the realtors in the making of the broad range of decisions in this community. It may be that typically the realtors do not effectively enter the decision-making processes. Or, it may be that they do, but in such a way that they are not recognized as a power group. It may be that people traditionally think of the mass media and business groups as being influential in the decision-making process, whether they actually are or not.

In the Grand Rapids study cited earlier it was found that the real estate board had been very effective in influencing a large number of significant community decisions, both in the arena of elections and in the arena of

governmental decisions of boards and commissions. However, this position of social power was recognized by only a small percentage of community leaders and, in fact, by only a small percentage of realtors themselves. This "sleeping effect" may also be involved in the decision-making process in Kalamazoo and other communities, an important consideration for those concerned with social action programs.

## V

FROM THE STANDPOINT of social theory and research methodology these findings raise questions about the validity of the reputational method of determining social power. It appears that this technique may be a measure of prestige rather than power. Although there are conversions possible between prestige and power, it is also true that a person or group may have high prestige and little power or low prestige with great power. This latter tendency is accentuated by the fact that power is often evaluated negatively in our society. To be called a "powerful" something is more generally a term of opprobrium than one of encomium. The relationship between reputed social power and actual social power is in a sense analogous to the relationship between a public opinion poll, whereby we get to know what people think they think, and the election results, when we find out what people actually think. In another sense, there is an analogy in the ratings baseball teams are given prior to the season by knowledgeable people and the standings at the end of the playing season.

There is a need to study social power in the arena of actual community decision-making. One may contemplate and debate and sample opinion as to the influential groups in a community, but an election involving the alignment of representative organizations of the city on a controversial issue is the moment of truth, at least for the issue involved. What are needed are additional studies which test the reputational method against the issue-analysis method in a wide variety of on-going community decisions.

## VI

## Summary and Conclusions

THIS STUDY INVESTIGATED the reasons why a housing proposal was defeated in a midwestern community in spite of the active support of almost every organization. The situation was considered ideal for the utilization of the issue-analysis method of determining social power because the issue was clear-cut, controversial, generated considerable public attention, and involved practically every influence group in the community.

Six suggested explanations for the negative vote were found to be

inadequate. They were: Failure to see the need for change, voter confusion, the non-voter, hesitancy to vote a tax increase, inadequate campaign on part of proponents, and conservatism of the Dutch ethnic group.

The study found the primary explanatory factor to be the social power position of the real estate board which was found to be a key influential in the decision-making processes of the community. The realtors were the only group to oppose the proposal, and the voters were found to have voted no for the same reasons the realtors used in the campaign.

Members of community organizations allied themselves with the position of the realtors and did not vote in accord with the publicized position and advice of the organizations. Neither Republicans nor Democrats voted in line with the recommendations of their parties, church members rejected the advice of religious groups, and union members did not follow the stand of the unions.

Respondents repeatedly stated that the realtors had a selfish interest in the outcome of the election, but this did not seem to bother them. Whether the realtors shaped the values of the voters to produce a negative vote, or whether they tuned in on the value system of the community and articulated it, the people voted no because of the influence of the realtors.

Validity of the reputational method of determining social power was questioned. Used in a context which could only have loaded responses in the direction of the realtors, a reputational question failed to produce the realtors as an influential group.

It appears that studies of social power that are to yield meaningful results must be issue oriented. The actual influentials can be best identified through an analysis of the decision-making processes of a community.

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### *173 Nations in Educational Exchange*

MORE THAN 140,000 PERSONS—college and university students, teachers, and scholars—participated in the educational exchange program between the United States and 172 other countries and territories in 1966–67. This record figure included a total of 100,262 students from abroad enrolled in 1,797 American institutions of higher learning and more than 10,700 professors, scholars, and researchers from 118 countries. [From the U.S. Department of State.]

# Political Partisanship:

## *Its Social and Economic Bases in the United States\**

By DAVID R. SEGAL and DAVID KNOKE†

**ABSTRACT.** Analysis of the bases of political party choice in the United States reveals that social structural factors are more important than economic factors in determining patterns of partisanship. Among economic factors, moreover, differentiation in the realms of credit and consumption is more important than differences in relation to economic production. The absence of traditional class-conflict politics, however, does not lead to a state of political consensus, because new modes of economic differentiation have emerged, cleavages based on earlier economic cleavages have persisted after the basic economic issues have been resolved, and non-economic cleavages, particularly along racial lines, still await resolution.

### I

#### The Economic Basis of Politics

SOCIOLOGY'S LOVE AFFAIR with Marxian models of society is over.<sup>1</sup> Despite the monistic views of political power contained in the writings of Mills and Hunter,<sup>2</sup> political sociology has moved far from economic determinist notions of political behavior.<sup>3</sup>

In a more general sense, however, the role of economic variables in political life remains undefined. Research seeking to relate economic self-interest to political involvement has failed to show significant relationships

\* Paper prepared for presentation at the 1969 meetings of the American Sociological Association. This research was conducted during the senior author's tenure as a Faculty Research Fellow, Horace H. Rackham School of Graduate Studies, University of Michigan, and was supported in part by a research grant from the Graduate School.

† We are indebted to John Sonquist and to Stephen Wildstrom for technical assistance. Professor James Morgan generously granted us access to the data contained herein.

<sup>1</sup> For a statement of Marx's impact on political sociology, see Seymour Martin Lipset, "Political Sociology," in Robert K. Merton, *et al.*, *Sociology Today* (New York: Harper and Row, 1965), Vol. I, pp. 84ff.

<sup>2</sup> See especially C. Wright Mills, *The Power Elite* (New York: Oxford University Press, 1956), and Floyd Hunter, *Community Power Structure* (Chapel Hill: University of North Carolina Press, 1953).

<sup>3</sup> The major departures from the Marxian model, I believe, are reflected in Seymour Martin Lipset, "The Changing Class Structure and Contemporary European Politics," *Daedalus*, Vol. 93 (Winter, 1964), pp. 271-303, and Morris Janowitz and David R. Segal, "Social Cleavage and Party Affiliation," *American Journal of Sociology*, Vol. 72, No. 6 (May, 1967), pp. 601-18.

between these variables,<sup>4</sup> and the argument has been put forth that in American politics, the rhetoric of economics has been adopted as a "conventional shorthand" for issues that are in reality political or moral.<sup>5</sup> This argument concludes on the note that the convention has outlived its usefulness: in part because politicians have forgotten that it is a convention and have begun to believe that economics controls politics, and more importantly, because the dominant cleavages in American society today do not lend themselves to economic analysis with the same facility that earlier issues did.

On the other hand, the relevance of Marx's economic notions of social class is still argued by some,<sup>6</sup> and in more general terms, Wiley has suggested that Marxian explanations of American politics fail not because Marx's model was economic, but because Marx did not go far enough in seeking out the economic markets that serve as the bases of class conflict.<sup>7</sup> Specifically, while the increased skill level and bargaining power of the working class may lead to the *embourgeoisement* of the proletariat, and the trend from entrepreneurial to bureaucratic occupations alienates managers as well as workers from the means of production thereby diminishing the import of the labor market as a source of social conflict, Wiley asserts that differential placement in the credit or commodity markets may serve as bases for political conflict.

Multivariate analyses of the bases of political partisanship in the United States have never taken into account this range of economic variables. Moreover, those economic variables that have been included have not been shown to bear a strong relationship to political partisanship. A study by one of us (Segal) of over 5,000 respondents, representing the American electorate from 1952 to 1964, revealed that social class, region, race, religion, urbanization, and union membership serve as the primary bases of partisan cleavage.<sup>8</sup> Income, which was included in the analysis, did not emerge as an important predictor.

<sup>4</sup> Frank Lindenfeld, "Economic Interest and Political Involvement," *Public Opinion Quarterly*, Vol. 28, No. 1 (Spring, 1964), pp. 104-11.

<sup>5</sup> Peter F. Drucker, "On the 'Economic Basis' of American Politics," *The Public Interest*, No. 10 (Winter, 1968), pp. 30-42.

<sup>6</sup> George Lichtheim, "Class and Hierarchy: A Critique of Marx?" *European Journal of Sociology*, Vol. V, No. 1 (1964), pp. 101-11. Also Bertell Ollman, "Marx' Use of Class," *American Journal of Sociology*, Vol. 73, No. 5 (March, 1968), pp. 573-80.

<sup>7</sup> Norbert Wiley, "America's Unique Class Politics: The Interplay of the Labor, Credit and Commodity Markets," *American Sociological Review*, Vol. 32, No. 4 (August, 1967), pp. 529-41.

<sup>8</sup> David R. Segal, "Classes, Strata and Parties in West Germany and the United States," *Comparative Studies in Society and History*, Vol. 10, No. 1 (October, 1967), pp. 66-84.

This set of variables, however, does not preclude partial economic explanation. Class identification is based, at least in part, on economic considerations,<sup>9</sup> and it is difficult to differentiate between the sociological and the economic import of occupation and union membership, at the very least. Moreover, Hamilton has shown, for the case of Germany, that even with income held constant, political party choice differs between working-class and middle-class as a function of life-style differences.<sup>10</sup> While life-style and position in the commodity market are not isomorphic, the relationship is surely strong enough to warrant further consideration.

The proposition that consumer behavior is an important indicator of behavior in other spheres is not a novel idea. Schelsky, for example, suggests that the relationship between consumer roles and occupational roles is decreasing, and that the former is becoming the central determinant of behavior.<sup>11</sup> Riesman clearly subscribes to this view with regard to American society. "The spread of other-direction has brought to the political scene the attitude of the inside-dopester, originating not in the sphere of work but of consumption."<sup>12</sup>

## II

### Research Goals

THE PRESENT STUDY is an attempt to evaluate the relative import of social and economic bases of political cleavage. Utilizing data from a survey of economic behavior conducted by the Survey Research Center, University of Michigan, in 1965, we analyzed the relationships between variables reflecting position in the labor, credit, and commodity markets, on the one hand, and political partisanship on the other. Similarly, we studied the relationships between social structural factors and partisanship, and, most importantly, we analyzed the interrelationships among all of these variables.

The mode of analysis was the automatic interaction detection (AID)

<sup>9</sup> Robert W. Hodge and Donald J. Treiman, with the help of a desk calculator named Stuart, show that while ownership of stocks and bonds in private companies, savings bonds, and related property, all of which may be taken as indicative of position in the credit market, make no significant contribution to the explanation of class identification, family income, along with education, occupation, and the occupations of one's associates, makes an independent contribution to the explanation of social class. See their "Class Identification in the United States," *American Journal of Sociology*, Vol. 73, No. 5 (March, 1968), pp. 535-47.

<sup>10</sup> Richard F. Hamilton, "Affluence and the Worker: The West German Case," *American Journal of Sociology*, Vol. 71, No. 2 (September, 1965), pp. 144-52.

<sup>11</sup> Helmut Schelsky, "Sozialenantiomer Wandel," *Opus Welt*, No. 41 (1956), pp. 65ff.

<sup>12</sup> David Riesman, *The Lonely Crowd* (New Haven: Yale University Press, 1961), p. 180.

algorithm developed by Morgan and Sonquist.<sup>13</sup> The sample was progressively split into smaller units on the basis of the ability of predictor variables to explain variance in party choice. The criteria for assigning priorities to predictor variables were purely statistical.

### III

#### Data Inputs

POLITICAL PARTISANSHIP was measured on a 7-point Likert-type scale ranging from strong Republican to strong Democrat. In the present analysis, intervals are assumed to be equal. Position in the labor market was indexed by employment status, whether or not self-employed, reasons for considering job changes, and desire to go into business for oneself. Relative position in the commodity market was measured by ownership of major appliances (automatic clothes washer, clothes dryer, dishwasher), and by the number of automobiles owned by members of the household. Position in the credit market was indicated by home ownership, liquid assets, income, and automobile financing.

### IV

#### Expectations

ASSUMING THAT EITHER social or economic factors predominated, a wide range of outcomes was possible. If in fact the economic variables proved to be more important than social structural factors, we might have produced a value-added model, wherein support of the Republican Party was related to holding advantaged positions in the credit, labor, and commodity markets. The most strongly Republican, then, would be those with advantageous positions in all three markets. Alternatively, we might have expected an interaction model, following Wiley's reasoning, such that the stress caused by class inconsistency would lead to political preferences of the right stronger than those due to consistent economic advantages. Class consistency is defined as being either propertied or non-propertied across the three economic markets in question. Thus, the propertied employer-creditor-seller is consistent, as is the non-propertied employee-debtor-buyer. All other sets are inconsistent.<sup>14</sup>

On the other hand, if social structural factors emerged as preeminent, we anticipated replication of the social groups defined by Segal as the

<sup>13</sup> John A. Sonquist and James N. Morgan, *The Detection of Interaction Effects* (Survey Research Center, University of Michigan, 1964).

<sup>14</sup> Wiley, *op. cit.*, p. 536.

components of the American electorate.<sup>15</sup> Perfect replication was not possible, since some variables included in the earlier study were absent from the present data set, *e.g.*, union membership, while we had data in this analysis that had not been included in the earlier study, *e.g.*, church attendance. These differences notwithstanding, if the social groupings defined by this analysis were roughly comparable to earlier results, it would attest to the reliability of those results.

Finally, our results might have produced not a "pure" sociological model or economic model, but a hybrid involving elements from each class of variables. Such data would have made the task of interpretation horrendous. Our faith in the analytic autonomy of sociology and economics led us to believe that these sets of theoretically distinct variables would emerge as empirically distinct entities, and our proclivities as sociologists led us to believe that the emergent model would be sociological rather than economic. We hasten to point out, however, that this expectation was preferential rather than theoretical.

## V

### Results

TO A GRATIFYING DEGREE, our expectations *qua* preferences were borne out, with but three systematic differences between our own social map of the electorate and that suggested earlier by Segal. These differences modified the characteristics of the social groups produced by the analysis, but did not substantially alter the sources of variance in partisanship.

As we anticipated, social structural and economic variables bifurcated into two independent sets, with the former identifying the major segments of the electorate and the latter being rejected for want of explanatory power. The sole exception to the generalization was income. In terms of family units, both the rich and the very poor expressed a preference for the Republican Party, presumably for different reasons. Income had been included in the earlier analysis and had failed to emerge as a significant predictor of party choice. The fact that high income people prefer the Republican Party, however, has often been documented.<sup>16</sup> The Republican identification of the poor is more difficult to explain, except perhaps in terms of the authoritarianism that has been alleged to characterize segments of the working class.<sup>17</sup>

<sup>15</sup> Segal, *ob. cit.*, pp. 78-79.

<sup>16</sup> See, for example, V. O. Key, Jr., *Politics, Parties and Pressure Groups* (New York: Crowell, 1964), pp. 598-90.

<sup>17</sup> See, for example, Seymour Martin Lipset, "Democracy and Working Class Authoritarianism," *American Sociological Review*, Vol. 24 (1959), pp. 482-501.

The partisanship of the Protestant middle-class also varied as a function of the relative affluence of community of residence. People living in wealthy counties were more likely to be strong Republicans than were people living in poor counties. It is difficult to judge whether partisanship in this case is a function of individual or collective properties. Previous research suggests that the middle-class is less susceptible to contextual effects on partisanship than is the working-class.<sup>18</sup>

The second major difference from previous work is what we regard as the emergence of a socialization dimension. The effect of family orientation on one's political preference was reflected in Segal's earlier research by the fact that the occupation of the respondent's father was a stronger predictor of partisanship than was the respondent's own occupation. This fact, however, was noticed only in passing, since the greater part of the variance in partisanship was explained by region and, to a lesser degree, by class identification. In the present analysis, regionalism was measured both by the area in which the respondent lived, and the area in which his father had lived. The respondent's own region was not represented in the final characterization of electoral groups, but the father's region emerged as the strongest predictor of partisanship, with the children of Southerners and immigrants showing a marked preference for the Democrats.<sup>19</sup>

Finally, in this analysis, in addition to political differentiation between White Protestants and members of minority religions, we achieved further specification among White Protestants as a function of church attendance. Those Protestants who attended church with some regularity were more Republican than those who attended seldom or never. This is in full agreement with Lenski's finding that "Among White Protestants, the proportion of Republicans varied directly with degree of involvement in the churches."<sup>20</sup> As noted above, the involvement dimension was not included in the earlier study.

<sup>18</sup> David R. Segal and Marshall W. Meyer, "The Social Context of Political Partisanship," in Mattei Dogan and Stein Rokkan, *Quantitative Ecological Analysis in the Social Sciences* (Cambridge: M.I.T. Press, 1969), pp. 217-32.

<sup>19</sup> The Southern Democratic vote is mentioned in Segal, *op. cit.* For a discussion of ethnic preference for the Democratic Party, see Michael Parenti, "Ethnic Politics and the Persistence of Ethnic Identification," *American Political Science Review*, Vol. 61, No. 3 (September, 1967), pp. 717-26. M. Kent Jennings and Richard G. Neimi discuss the high intergenerational correlation of political partisanship in "The Transmission of Political Values from Parent to Child," *American Political Science Review*, Vol. 62, No. 1 (March, 1968), especially pp. 172-74.

<sup>20</sup> Gerhard Lenski, *The Religious Factor* (Garden City: Doubleday, 1963), p. 174.

Table 1

SOCIAL STRUCTURAL CLEAVAGE IN THE AMERICAN POPULATION

Category	N	P.C.	$\bar{Y}$
1. Negro Democratic Bloc. Father from South or foreign born; household head non-White	193	9	6.02
2. Southern and Ethnic Democrat. Father from South or foreign born; household head White; Baptist Catholic, Jewish, non-traditional Christian	696	33	5.27
3. Minority Religion. Father native-born non-South; Catholic or Jewish	253	11	5.13
4. Working-Class Oriented. Father native-born non-South; clerk, laborer or operative; does not attend church regularly; Lutheran or minor Protestant sect	131	6	5.02
5. Southern and Immigrant "Core" Churches. Father from South or foreign born; household head White; Methodist, Presbyterian, Episcopalian, Lutheran			
5.1 Family income \$2,000-10,000	175	8	4.90
5.2 Family income < \$2,000 or > \$10,000	115	5	3.77
6. Marginal Middle Class. Father native-born non-South, Protestant; professional, technical, managers, owners, proprietors, housewives; dwell in counties of median income < \$4000	32	2	4.75
7. Protestant-Oriented. Father native-born non-South; core Protestant church; clerks, laborers, operatives			
7.1 Irregular church attendance	189	9	3.96
7.2 Regular church attendance	137	6	3.54
8. Middle-class Protestant. Father native-born non-South; Protestant; professional, technical, managers, officials, proprietors, housewives; median county income > \$4,000			
8.1 Attend church seldom or never	110	4	3.50
8.2 Attend church regularly or often	113	5	2.42
Total	2,138	98*	4.72

Table 1 presents the social groupings in the American electorate pro-

\* Per cents do not total 100 due to rounding.

duced by this analysis. The dependent variable,  $\bar{Y}$ , is the mean partisanship score for the group, based on a 7 point scale, with Democrats at the high end. The three most strongly Democratic groups are defined by black skin, Southern or immigrant origins, and membership in minority religious groups. These three sources of traditional Democratic support accounted for more than 50 per cent of the total sample.

The most strongly Republican group was the Protestant middle-class, consisting of professionals and self-employed businessmen, with non-Southern and non-immigrant origins, living in high-income counties. Among them, church attendance was related to Republican preference.

Also tending to support the Republican Party ( $\bar{Y} < 4.0$ ) were non-Southern Protestants in the upper-working class and lower-middle class. Here again, church attendance was related to Republicanism. These groups accounted for about 24 per cent of the total sample.

Less strongly aligned with the major parties, but, with one exception tending to support the Democratic Party ( $\bar{Y} > 4.0$ ) were Southern oriented, working-class oriented, and marginal middle-class respondents. On the whole, groups representing roughly 29 per cent of the sample preferred the Republican Party. This is consistent with Segal's earlier work on both the structure of the American electorate, and the alignment of party strength in the 1960's.<sup>21</sup>

## VI

### Discussion

THESE DATA DEMONSTRATE CLEARLY that social structural factors are stronger predictors of political party choice than are purely economic factors. On the other hand, there are clear differences in relationship to partisanship among the three economic markets we have considered. Of the three, position in the credit market, in terms of having cash to dispose of, is most strongly related to party choice. Position in the labor market bears the weakest relationship to partisanship, and position in the commodity market is roughly intermediate between the other two. Thus, while economic factors are secondary, to the extent that they are important, it is differentiation in the realm of consumption rather than of production that matters. Zero-order relationships between representative social and economic factors and political partisanship are presented in Table 2.

<sup>21</sup> See Segal, *op. cit.*, and "Partisan Realignment in the United States: The Lesson of the 1964 Election," *Public Opinion Quarterly*, Vol. 32 (Fall, 1968), pp. 441-44.

While our data testify against the existence of political cleavage based upon economic classes in the United States, they do not support the inference, drawn by some, that cleavages in American society have lost most of their impact for most people and have been transformed into a consensual political style.<sup>22</sup> Such theorists accept the Marxian dictum that social relations are built upon an economic substructure defined in terms of productive relationships, and see a decrease in conflict in the productive sector of the economy. Research on political cleavage in the United States points to three fallacies in this line of reasoning.

Table 2  
REDUCTION IN POLITICAL PARTISANSHIP

Zero Order Variance Reduction in Political Partisanship Attributable to Social and Economic Factors	
Variable Name	Reduction in Variance*
<b>Social Structural Factors</b>	<b>Per Cent</b>
Area Father Raised	5.68
Religion	4.30
Race	3.67
Occupation	3.10
Education	2.85
<b>Position in Credit Market</b>	
Liquid Assets	2.58
Disposable Income	2.14
<b>Position in Commodity Market</b>	
Number of Automobiles	1.08
Appliance Ownership	0.98
<b>Position in Labor Market</b>	
Self Employment	0.24
Employment Status	0.23

\* Expressed in terms of per cent by which the total sum of squares of political partisanship is reduced by dichotomizing in terms of independent variable so as to maximize between groups sum of squares.

First, as Wiley suggests, the labor market, which governs productive relationships, is not necessarily the most important economic arena for political discourse. Like Schelsky, we find that consumption relationships are more likely than production relationships to serve as bases of political alignment.

<sup>22</sup> See Robert E. Lane, "The Politics of Consensus in an Age of Affluence," *American Political Science Review*, Vol. 59 (December, 1965), pp. 874-95.

Second, where real economic cleavages once existed and served as the bases of political differentiation, we now find residues of those cleavages that have become part of subcultural systems, and are transmitted inter-generationally even in the absence of the basic economic conflicts that generated them. The political regionalism of the South was rooted in its defense of a system of plantation agriculture dependent upon the institution of slavery, and its opposition to the national bank in the early 19th century. While the economic base of the region has been changing, dating back to a sharp increase in industrialization in the 1920's, the drift away from regional politics has been gradual, and despite short-term fluctuations, is not to be expected to approximate the national two-party model in the immediate future.<sup>23</sup>

Finally, we find non-economic cleavages that have persisted through long periods of American history cast, as Drucker suggests, in the rhetoric of economic issues. The Kerner Commission, appointed by President Johnson in 1967, caused widespread controversy through its suggestion that the problems encountered by black men in their dealings with American society are due not to the fact that the black man is poor, but to the fact that he is black. The President himself was unable to accept the conclusion that America is a racist society, but Higham has shown that as early as the turn of the 20th century, American nativism had begun to focus on the issue of race.<sup>24</sup>

We posit, then, that given the decline of traditional class conflict in the United States, there are three major constraints to the development of consensual politics. First, we find the emergence of new bases of economic cleavage in the place of class conflict politics. Second, we find that political differentiation initially based on economic cleavage tends to persist even after the economic issues themselves are resolved. Third, we find persisting bases of cleavage in American society that do not lend themselves to simple solutions based upon economic rationality.

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<sup>23</sup> See Philip E. Converse, "On the Possibility of Major Political Realignment in the South," in Angus Campbell, *et al.*, *Elections and the Political Order* (New York: Wiley, 1966), pp. 212-42.

<sup>24</sup> John Higham, *Strangers in the Land* (New York: Atheneum, 1965), pp. 131-57. Also, see Richard Hofstadter, *Social Darwinism in American Thought* (Boston: Beacon Press, 1955), pp. 170-200.

# A Federal Program of Student Loans

By ROBERT J. CARLSSON

FOR VARIOUS REASONS, from the standpoint of both students and lenders, student loans are not as popular as they might be. Were loan programs more attractive, it is likely that more students would be able to further their education or at least finish their courses of study earlier. Accordingly, the purpose of this article is to devise a scheme, on the theoretical level, in which the negative incentive effects of loan programs are minimized and the positive incentive effects maximized.<sup>1</sup> First, some brief comments will be made concerning the general distaste for traditional loan programs along with an evaluation of existing federal student loan programs. Second, selected recent proposals for loan programs, namely those of Harris, Friedman and Vickrey, will be critically reviewed.<sup>2</sup> Third, a loan program which provides strong positive incentives will be suggested. Finally, some concluding comments regarding the practicality of such a scheme will be made.

## I

### Unpopularity of Traditional Student Loan Program

THE GENERAL UNPOPULARITY of traditional student loan programs<sup>3</sup> from the standpoint of the student seems to stem from the fact that there is a fixed repayment obligation. The student must assume this obligation at a time when he is probably very uncertain about the future so that he presumably has a strong fear of a possible future financial burden. While it is true that, on the average, future earnings will be large enough to allow repayment of the debt with interest and still provide a positive

<sup>1</sup> For convenience, throughout the discussion the term 'positive incentive effects' refers to those incentive effects which operate in favor of the loan program. In other words, positive incentive effects tend to induce individuals to utilize loan facilities. Conversely, negative incentive effects tend to discourage individuals from utilizing loan facilities, and thus are those which operate against the loan program.

<sup>2</sup> Seymour E. Harris, *Higher Education: Resources and Finance* (New York: McGraw-Hill, 1962), chs. 17-22. Milton Friedman, "The Role of Government in Education" in Robert A. Solo (ed.), *Economics and the Public Interest* (New Brunswick, N.J.: Rutgers University Press, 1955), pp. 123-44. William Vickrey, "A Proposal for Student Loans" in Selma J. Muskin (ed.), *Economics of Higher Education* (Washington, D.C.: U. S. Government Printing Office, 1962), pp. 268-80.

<sup>3</sup> This topic has been discussed in detail by a number of writers, consequently they are only summarized in this article. See, for example, Harris, *op. cit.*, Friedman, *op. cit.*, Vickrey, *op. cit.* In addition see Richard S. Eckaus, "Education and Economic Growth," in Selma J. Muskin, (ed.) *Economics of Higher Education*, *op. cit.*, pp. 102-28, but esp. p. 125 *ff.* and Roy E. Moor "The Federal Government Role in Higher Education" in Muskin, *ibid.*, pp. 202-18, esp. p. 216 *ff.*

return on the educational investment, this condition may not hold for each and every student. The student may be uncertain as to whether his future income will be average, above average or below average. Furthermore the student may be contemplating marriage and may be even more hesitant to assume such a financial obligation at the start of family life. With respect to women students, this effect might even be stronger.

There are other incentive effects with regard to traditional loan programs. There is a bias in favor of high-paying occupations. Because of the fixed repayment obligation, there would be a strong incentive for graduates to take higher paying jobs rather than lower paying ones which might be more appealing to them were it not for their financial obligations. Alternatively, students who plan on entering higher paying occupations would be more apt to borrow than those desiring to enter lower paying ones. Thus with traditional loans there is discrimination against such occupations as education, social services and the like. Furthermore, loan programs would presumably be more attractive to those students whose families were in a middle or higher income group. This might follow either because they are more accustomed to or exposed to credit, or because they realize or believe that their families would help assume the obligation if great financial difficulty were experienced. Still another factor might be that under traditional plans, loans of adequate size with a long repayment term are difficult to arrange.

For similar reasons private lenders hesitate to expand their operations in the student loan field. Aside from the risk factor and a relatively long repayment period, public pressure is exerted to keep interest rates low. Thus private lenders seem to prefer lending in other areas where the return is higher.

The federal government has already entered the student loan field. The Higher Education Act of 1965 introduced among other things the Guaranteed Loan Program and the National Defense Student Loan Program. The Guaranteed Loan Program insures or guarantees educational loans made voluntarily by private financial institutions. In addition the government pays all interest, though not exceeding 6 per cent, while the student is in school. Upon leaving school the student pays 3 per cent interest charges and the government pays 3 per cent. However, if the family income before taxes were \$15,000 or greater, the student would pay the entire 6 per cent. In the case of the National Defense Student Loan, the government supplies 90 per cent of the loan and the college 10 per cent. No interest payment is required while the student is in school at least halftime. There is a 3 per cent interest charge and a repayment

period of a maximum of ten years to start one year after leaving school. There are, however, appropriate postponements of payment for military service, Peace Corps, etc. The undergraduate student can borrow up to \$1,000 per year with a maximum of \$5,000 total, while graduate students can borrow up to \$2,500 per year with a maximum of \$10,000 total. In addition the student can cancel 10 per cent of the loan each year to a maximum of 50 per cent if he becomes a teacher. If he becomes a teacher in a "deprived" area, 15 per cent of the loan is cancelled each year and the entire loan may be cancelled in this manner.

These two federally sponsored programs reduce some of the negative incentive effects of traditional loan programs. However, they are still open to criticism. The student still has a fixed repayment obligation, though of course the terms are easier than in the private sector. Nevertheless, the objections emanating from the fixed repayment obligation are still present. Furthermore with regard to the National Defense Student Loan program there is a bias in favor of the teaching profession. Although it may be desirable to attract more teachers, this method raises serious objections. It seems likely that some students would enter the profession merely to cancel the loan or at least part of it. After this has been accomplished, they may, in large part, move to other occupations. In addition many of those who entered the teaching profession primarily as a means of reducing the debt might not make particularly good teachers. It may be suggested too, that other lower paying occupations need additional personnel. Thus while the teaching profession may gain in quantity, that gain might be at the expense not only of higher paying occupations but also of other lower paying occupations. Clearly the current federal program is not adequate. Furthermore, in the case of the Guaranteed Loan Program, higher income families pay higher interest rates. Thus there is a bias toward lower income families and against higher income families.

## II

### Proposals of Harris, Friedman and Vickrey

SINCE THE PROPOSAL by Seymour Harris is more closely related to traditional loan programs than those of Friedman and Vickrey, it will be discussed first. Harris contended that a federal program would be required in order to insure an ample supply of funds.<sup>4</sup> He favored long-term, low interest loans, which would be an improvement over existing programs. A 20- or 40-year loan at 2 per cent interest would be typical under the

<sup>4</sup> Harris, *op. cit.*, pp. 279-80.

Harris scheme.<sup>5</sup> If the interest rate were as low as 2 per cent, an element of subsidy would be involved since the treasury would have to borrow at some rate greater than 2 per cent. This provides a reduction of the financial burden to the borrower as do productivity increases and inflation.<sup>6</sup> Thus the Harris suggestion makes the strong positive contribution of eliminating to a large extent the burden of the fixed repayment obligation. However, a fixed repayment obligation does remain. The fear on the part of the student that his future income will be below average and so will experience financial difficulties remains, as does the bias against lower paying occupations.<sup>7</sup>

Milton Friedman argued that imperfections in the human capital market would justify federal government intervention, though he did recognize the feasibility of an equity investment plan coupled with limited liability to the stockholders.<sup>8</sup> Friedman suggested that the government provide funds directly to the student for specialized training. The individual would then pay back to the government a certain percentage of his annual income above a floor. The percentage of income repaid by the student should be set at a level which would make the project self-financing. The floor income would be either the average or modal earnings of those individuals without the specialized training. As Friedman indicated, the payments could easily be made in conjunction with the income tax so that administration of such a plan would be relatively easy.<sup>9</sup>

Friedman's plan has the distinct advantage of eliminating the fixed repayment obligation, which in turn eliminates much of the negative incentive effects arising from uncertainty. Under his plan the actual amount of repayment depends directly on the individual's income in excess of some floor. Although Friedman suggested the floor be the average or modal earnings without the specialized training, it could be raised in order to compensate for income forgone while the individual was being educated, and still keep the essence of the plan intact.

Thus, in this scheme the individual would be given a strong incentive to invest in his education. There is a built-in loss offset feature, so that if the individual receives income equal to or less than he could expect to gain without the training, he pays no direct cost. This feature would

<sup>5</sup> *Ibid.*, pp. 280-93. Although Harris did not suggest a specific rate of interest, he seemed to favor 2 per cent. See especially his example and discussion pp. 280-82.

<sup>6</sup> *Ibid.*, p. 298.

<sup>7</sup> *Ibid.* It should be noted, though, that Harris takes some account of the difficulties of lower paying professions. See esp. pp. 298 ff.

<sup>8</sup> Milton Friedman, *op. cit.*, p. 136 ff.

<sup>9</sup> *Ibid.*, p. 140.

eliminate much of the reluctance on the part of students to borrow for their education. Of course a portion of any income above the floor would be allocated for repayment. However, the crux of the matter is that the individual only pays for his training if his income exceeds the floor; there must be a positive return before repayment is made. Furthermore, if the individual receives an income higher than the floor, he would presumably be better off financially than without the training. Thus it might be suggested that the individual has everything to gain and nothing to lose.

There are, however, negative incentive effects for those who expect to earn higher incomes. The repayments (except for the floor provision which adds an element of progressivity) may be considered proportional to income; therefore the individual's repayments increase as income increases. Since it is an open-ended distribution, those with relatively high incomes over their lifetime might repay multiples of the cost of their education. In some cases individuals might have been able to finance their education through private sources at a much lower cost. It can be objected, then, that those students who consider themselves likely to have above average lifetime earning power would not enter such a program.

Since the plan would seem to be most attractive to those who expect to earn relatively less over their lifetime, the result would be that the proportion of income allocated for repayment would have to be greater than would be the case if all students financed their education in this manner. Friedman recognized this possibility, but unfortunately did not pursue it far enough. Furthermore, Friedman also felt that the floor income and the percentage of income repaid should be calculated for each individual and each occupation.<sup>10</sup> Clearly the estimation of earning capacities for individuals and occupations would be difficult and costly. Too many factors would have to be considered for accurate estimates. Some of these factors are: defining the occupation, estimating and quantifying the current and future status of the occupation, ability of the individual, income from other sources, family income, regional differences, racial characteristics and possible changes of occupation. In addition, Friedman neglected the possibility of women getting married and leaving the labor force. These seem to be the major defects in his scheme.

William Vickrey has also suggested a plan whereby repayment is a function in income above a certain floor.<sup>11</sup> Vickrey felt that the private sector could establish and operate an effective student loan program based

<sup>10</sup> *Ibid.*, pp. 141-42.

<sup>11</sup> William Vickrey, *op. cit.*

on techniques of mutual investment, limited dividend corporations, pension funds and income taxation. Under his plan the student could finance his education by agreeing to return dividends based on future earnings. Vickrey suggested that rate schedules and exemptions be established in such a manner that the dividend payments would be related to income above some floor. The floor would be the level of earnings the individual could expect without the additional education.<sup>12</sup> Vickrey realized that predicting the relation between education and earnings would be difficult. However, he claimed the mutual fund plan would effectively reduce the magnitude of the problem. He suggested the earnings dividend schedule yield at least 6 per cent and possibly 8–10 per cent. This relatively high rate would foster internal accumulation and presumably attract outside capital at low interest rates. Later in life the individual would receive a return on his dividend payments in the form of a death benefit or a retirement annuity.<sup>13</sup>

Vickrey suggested a risk rating scheme based on educational potential in order to eliminate adverse risk selection.<sup>14</sup> In this case adverse risk selection would result if there were a tendency for those who expected low incomes over their lifetime to be the only group, or the major group, of applicants. This would occur in the absence of any risk rating. In addition the adverse risk selection could be reduced further by the method used in paying the retirement benefits.<sup>15</sup>

Vickrey's plan, like Friedman's, is based on the repayments being a function of income. A major difference between them is that Friedman relies on the public sector, while Vickrey relies on the private sector. A major improvement in Vickrey's scheme is the minimization of adverse risk selection, so that there would be a greater incentive for students to participate who expect high incomes. However, Vickrey's proposal is not without its drawbacks. A major practical defect is that it would be difficult to establish such a program. It seems doubtful that the private sector will take the initiative in the near future. Another practical difficulty concerns the method of relating and forecasting income to educational levels on an individual basis. In any event the administrative cost would be high. It is also possible that the retirement annuity or death benefit may not provide the necessary positive incentive effects. Instead of the annuity, individuals may prefer to repay less over their working life and consume

<sup>12</sup> *Ibid.*, pp. 269–70.

<sup>13</sup> *Ibid.*, p. 271.

<sup>14</sup> *Ibid.*, pp. 274–76.

<sup>15</sup> *Ibid.*, p. 277.

more, or invest in other securitise. Still another problem relates to women students who leave the labor force soon after leaving school. Although this problem could be solved via the risk rating scheme, it would be difficult.

### III

#### The Proposal

IT HAS BEEN SHOWN that each of the proposals discussed above has inherent advantages and disadvantages. The following is an attempt to devise a scheme which maximizes the advantages, but minimizes the disadvantages of the above plans.

The plan suggested here is of the federal variety—as are the Harris and Friedman plans—on the grounds that it appears unlikely that the private sector would be willing to undertake such a scheme at the present time. However, it will be shown that with little modification, the scheme could be operated by the private sector. Like the Friedman and Vickrey proposals, the repayments are functions of income above some floor. An essential difference is that in this plan there is also a *ceiling*. At this juncture a simple algebraic model will be presented.

$$(1) \sum_{t=0}^n \sum_{i=1}^z L_{it}(1+r)^{n-t} = \sum_{t=0}^n \sum_{i=1}^z R_{it}; (i = 1, 2, \dots, z); (t = 0, 1, \dots, n)$$

Where:  $L_{it}$  refers to the amount of a student loan to the  $i^{\text{th}}$  individual in time  $t$ .

$R_{it}$  refers to the amount of repayment by the  $i^{\text{th}}$  individual in time  $t$ .

$r$  refers to the rate of interest.

Equation (1) relates the future value of all student loans with interest compounded annually over time to the future value of all repayments over time.<sup>16</sup> Of course in the first few time periods the right hand side of equation (1) will be zero, and in the last few time periods (if the program were stopped) the left hand side will be zero. For simplicity (1) is assumed to be an equality; however, public policy may decide to intro-

<sup>16</sup> An alternative formulation of equation (1) in which the repayments also accrue interest is:

$$\sum_{t=0}^n \sum_{i=1}^z L_{it}(1+r)^{n-t} = \sum_{t=0}^n \sum_{i=1}^z R_{it}(1+r)^{n-t}$$

Since this would complicate the analysis and the numerical example which follows, the repayments will not accrue interest in this model. It is suggested that inclusion or exclusion of the interest on repayments makes little conceptual difference. In practice, though, including interest on repayments would reduce the amount of repayments.

duce the element of subsidy. If so the future value of all loans would exceed the future value of repayments. On the other hand, if public policy desired a positive return, the future value of repayments would exceed the future value of the loans. This last possibility would also be appropriate if the program were established and operated by private financial institutions.

Since repayments are assumed to be a function of income between a floor and a ceiling, the right hand side of equation (1) can be rewritten as:

$$(2) \sum_{t=0}^n \sum_{i=1}^z R_{it} = \sum_{t=0}^n \sum_{i=1}^k p_i(Y_{it}^f - F) + \sum_{t=0}^n \sum_{i=k+1}^s p_i(Y_{it}^m - F) \\ + \sum_{t=0}^n \sum_{i=s+1}^z p_i(Y_{it}^c - F) \\ (i = 1, \dots, k, k+1, \dots, s, s+1, \dots, z)$$

Where:  $Y_{it}^f$  refers to those individuals in time,  $t$ , who earn income equal to or less than the floor.

$F$  signifies the floor income.

$Y_{it}^m$  refers to those individuals in time,  $t$ , who earn income greater than the floor but less than the ceiling.

$Y_{it}^c$  refers to those individuals in time,  $t$ , who earn income equal to or greater than the ceiling. Since it is assumed that no repayment is made on income greater than the ceiling,  $Y_{it}^c$  can be considered a constant.

$p_i$  signifies the proportion of the income between the floor and ceiling to be repaid each time period by the  $i^{\text{th}}$  individual.  $p_i$  will be constant for the  $i^{\text{th}}$  individual over time, but  $p_i \neq p_j$ .

Equation (2) relates the total repayments over time to the range between the floor and ceiling incomes. The first term on the right hand side of equation (2) is included only to account for all borrowers. Actually, since  $k$  borrowers earn income equal to the floor or *less*, the term would most likely be negative implying a negative repayment. However, it is assumed that negative repayments would not be made. Thus,  $k$  borrowers do not make any repayment in time  $t$ . Of course any *one* borrower might not repay anything in one time period and the maximum in another time period. In any case this term equals zero so that equation (2) can be rewritten as:

$$(3) \sum_{t=0}^n \sum_{i=1}^z R_{it} = \sum_{t=0}^n \sum_{i=k+1}^s p_i(Y_{it}^m - F) + \sum_{t=0}^n \sum_{i=s+1}^z p_i(Y_{it}^c - F)$$

In light of equation (3), equation (1) can be rewritten as:

$$(4) \sum_{t=0}^n \sum_{i=1}^z L_{it}(1+r)^{n-t} = \sum_{t=0}^n \sum_{i=k+1}^s P_i(Y_{it}^m - F) + \sum_{t=0}^n \sum_{i=s+1}^z P_i(Y_{it}^c - F)$$

Once the ceiling and floor incomes have been established and an appropriate rate of interest chosen, the proportion of the income differential repaid in each period by the  $i^{\text{th}}$  individual depends directly on the size of the loan and the number of repayments.

Table 1  
FUTURE VALUES OF LOANS AT SELECTED YEARS  
(Interest Compounded Annually)

Years	Borrowed	Future Values of the Loan With Selected Interest Rates				
		2%	3%	4%	5%	6%
10	1,000	1,219	1,344	1,480	1,629	1,791
20	1,000	1,486	1,806	2,191	2,653	3,207
30	1,000	1,811	2,427	3,243	4,322	5,744
40	1,000	2,208	3,262	4,801	7,040	10,286
10	2,000	2,438	2,688	2,960	3,258	3,582
20	2,000	2,972	3,612	4,382	5,306	6,414
30	2,000	3,622	4,852	6,486	8,644	11,488
40	2,000	4,416	6,524	9,602	14,080	20,572
10	5,000	6,095	6,720	7,400	8,145	8,955
20	5,000	7,430	9,030	10,955	13,265	16,335
30	5,000	9,055	11,135	16,215	21,610	28,720
40	5,000	11,040	16,310	24,005	35,200	51,330
10	10,000	12,190	13,440	14,800	16,290	17,910
20	10,000	14,860	18,060	21,910	26,530	32,070
30	10,000	18,110	24,270	32,430	43,220	57,440
40	10,000	22,080	32,620	48,010	70,400	102,860

The choice of the floor and ceiling incomes will in large part determine the incentive effects. Some general comments concerning them follow:

1. The higher the floor the greater will be the positive incentive effect for those who expect or fear lower incomes either by lack of ability, or choice of lower paying occupations and conversely.
2. The higher the ceiling the greater will be the negative incentive effect for those who expect higher incomes and conversely.
3. The greater the spread between the floor and ceiling the greater will be the positive incentive effect for those expecting less than the average income differential and the greater will be the negative incentive effect for those expecting more than the average income differential, and conversely.

The values of the ceiling and floor actually chosen would presumably depend upon the objectives of society as reflected in public policy, which is far too broad a question to be discussed in this article. However, some general observations can be made, which may be illustrated by hypothetical, but plausible numerical examples. Table 1 shows the approximate amounts owed on loans of various sizes over selected time periods with selected

Table 2  
FUTURE VALUES OF REPAYMENTS FOR AVERAGE AND  
MAXIMUM INCOME DIFFERENTIALS AT SELECTED YEARS

Years	$p$	Repayment For Average Income Differential (2,000)	Repayment For Maximum Income Differential (3,000)
10	.05	1,000	1,500
20	.05	2,000	3,000
30	.05	3,000	4,500
40	.05	4,000	6,000
10	.1	2,000	3,000
20	.1	4,000	6,000
30	.1	6,000	9,000
40	.1	8,000	12,000
10	.2	4,000	6,000
20	.2	8,000	12,000
30	.2	12,000	18,000
40	.2	16,000	24,000
10	.3	6,000	9,000
20	.3	12,000	18,000
30	.3	18,000	27,000
40	.3	24,000	36,000
10	.4	8,000	12,000
20	.4	16,000	24,000
30	.4	24,000	36,000
40	.4	36,000	48,000
10	.5	10,000	15,000
20	.5	20,000	30,000
30	.5	30,000	45,000
40	.5	40,000	60,000

interest rates compounded annually. The range of interest rates from 2 to 5 per cent seems to be plausible for federal loans, though certainly they could be higher or lower. The 6 per cent interest rate seems to be a plausible minimum for the private sector; though it is quite possible the private interest rate might easily exceed 6 per cent.

Table 2 shows the amounts of repayment for an average and maximum income differential after selected time periods and for various values of  $p$ . The maximum repayment per year is based on an income differential of \$3,000, while the average is based on a differential of \$2,000. The average will certainly be higher than the arithmetic mean of the differential since it is an open ended distribution on the high side. In other words since only those whose incomes are above the floor enter into the calculation, the distribution will be skewed toward the higher incomes. To avoid complexities, the probability of earning income to the various time periods is assumed to be unity, (*i.e.* assumed to be a certainty). Thus the repayment amounts are somewhat overstated.

For simplicity it is assumed that if the total repayments using the average income differential are equated with the total amount of the loan, the total of *all* repayments (average, below average, and above average) will reach the desired amount. In other words, the levels of the floor and ceiling would be chosen in such a manner as to insure the desired amount of repayment, and that the individual who receives the average income differential repays exactly his share of the loan. This implies that those receiving higher than the average income differential repay more than their share and those receiving less than the average income differential repay less than their share. Thus the greater repayment of those with higher than average income differentials exactly offsets the smaller repayments of those with lower than average income differentials.

Although the repayments of those with higher than average income differentials would exceed their loan, in most cases their repayments would be less than with a traditional loan contract in the private sector. The individual with the ceiling income would pay less as long as the interest rate on the federal program is significantly less than in the private sector. When the 5 per cent rate is compared to the 6 per cent rate, in some cases those with the ceiling income would repay more with the federal program, but in others they would repay less. However, at a 4 per cent rate or less the maximum amounts repaid by the ceiling income recipients would in all instances be less than with a 6 per cent traditional loan from the private sector. Under these circumstances the federal program with repayments based on income would be more attractive to all students than a traditional loan in the private sector. Thus there are strong positive incentive effects in favor of the student loan program.

However, the incentive effects especially on the high income group must be discussed for the case in which two loan programs exist side by side and in which the interest rates are the same. If, for example, the

student has a choice between two loans, each at 3 per cent interest, but one with a conventional repayment plan and the other with the income-related repayment plan, which would he choose? Clearly those anticipating average or lower differentials would choose the repayment plan based on income. At first glance it might seem that those with more confidence in their ability or who anticipated relatively higher income differentials would choose the conventional plan since they would repay less than under the income repayment scheme. However, this is open to question. The income repayment scheme might be construed as a form of insurance policy. By choosing this plan the individual can avoid the risk of the financial burden he would incur if his actual income differential were less than the average. Because there is a ceiling, the individual knows the maximum amounts he might have to repay in each time period. The difference between the maximum and average repayments could then be construed as a risk premium and as such might be considered a bargain. Thus it is argued that even at the same interest rate on the loan, strong positive incentive effects may still exist in favor of the income-related repayment scheme, as opposed to one with a traditional repayment plan.

In the context of this model, it follows that if the interest rate on the income-related repayment plan is low enough vis-à-vis that on conventional type loans, the income-related repayment scheme would be preferred in all cases. If the interest rates are equal, those who are *certain* to receive less than the average income differential would prefer the income-related repayment scheme. Those who are *certain* to receive the average income differential would be indifferent. And those who are *certain* to receive a higher than average income differential would prefer the conventional plan. However, if there were *uncertainty*, the above conclusions no longer hold. In reality there is uncertainty, therefore it seems reasonable to surmise that for the most part those who expect to earn the maximum income differential would still prefer the income-related repayment scheme.

One difficulty that has not yet been considered and requires further study refers to the case of women students, who leave the labor force via marriage. Surely the probability of their working for the chosen time period is less than that of male students. One possible solution would be to raise the proportion of the income differential to be repaid vis-à-vis that of men students. However, this would simply increase the tendency for married women to leave the labor force. A second possible solution would be to add the women students' loan to those of their husbands' and

relate the repayment scheme to family income. A third alternative would be to convert the wife's loan to a conventional repayment plan. It seems that the second or third possibilities or perhaps a combination of the two would be more realistic.

These possibilities might be criticized on the grounds that such programs would discourage women from using loan facilities lest they become a negative dowry. However it is argued that the negative incentive effects would be no greater under the plan presented above than under conventional loan programs and in fact would be less. Thus, although the difficulties relative to women students still remain, the income-related repayment plan appears to reduce them.

#### IV

##### Concluding Comments

IT CAN BE CONCLUDED on theoretical grounds that an income-related repayment scheme incorporating a floor and a ceiling provides greater positive incentive effects in favor of student loans and less negative incentive effects for all types of students than conventional or other loan programs that have been proposed. The positive incentive effects are greater than with the Harris proposal since the fixed repayment obligation is eliminated. They are greater than in the Friedman plan since there is a ceiling which provides positive incentive effects to higher income groups. Finally they are greater than in the Vickrey proposal since the cost of the loan to the individual would be less and the individual would not have excess repayments frozen until death or retirement. In addition it is doubtful that the private sector will establish such a program in the near future.

It now remains to discuss the practical aspects of the proposal. Little difficulty should be encountered in administering the plan, since it could easily be incorporated into the present income tax program. Thus the administrative costs would be low. The great flexibility inherent in the scheme is also of great practical value. The choice of the ceiling and floor income, the portion of the income differential repaid and the interest rate can be made so that the plan would either be subsidizing, self-liquidating or profit-making as society desires. Finally, the volume and amounts of the loans could easily be made large enough so as to permit all qualified students to start and finish their education.

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### *Agrarian Land Reform in Syria*

DURING 1969 REDISTRIBUTION of land under the Syrian Agricultural Reform Law of 1958 was stepped up, amounting to 168,000 hectares and involving 471 villages. While initially progress under this Law had been slow, after 1963 expropriation and redistribution increased substantially.

Ceilings on land ownership were set at 15-50 hectares for irrigated land and 80-200 hectares for rainfed land. By the end of 1969 a total of 1.5 million hectares had been expropriated, of which 75 per cent was rainfed land, 19 per cent uncultivated, 5 per cent irrigated, and 1 per cent forested.

However, progress in redistribution was not as rapid, with only 380,000 hectares being redistributed to farmers by the end of 1969; another 200,000 hectares were not considered suitable for redistribution. The redistributed land was allotted to 32,000 families. [*Le Commerce du Levant*, Beirut, April 8, 1970, summarized in *International Financial News Survey*, May 1, 1970.]

## Tax-Induced Slow Turnover of Capital, III

By MASON GAFFNEY

### III

#### Constant Value Assets: the Full Salvage Case

WE BEGAN with the point-input point-output case, thinking it was the simplest. It turned out to be rather complicated. That was partly because we took advantage of its simplicity to introduce a number of complications and establish beyond cavil our general thesis of a bias to longevity. That was worth some care, even though only a few real assets approximate the point-input point-output model, because all other models may be constructed as summations of point cases, and what is true for each of the parts is almost surely true for the whole.

Indeed, with that thought we might almost close here and take the remainder on faith. But as it happens some of the more complex models are easier to understand than the point case. Further, it is not immediately obvious from the point case what depreciation schedule would be neutral, how to judge the bias in schedules commonly used, or how to judge interclass bias. Also, critics of Austrian capital theory have never accepted the generality of the tree case. Finally, the more complex models help us frame some wider generalizations which we would leave with the reader.

We next consider an asset whose salvage value at maturity equals its initial cost; and which yields a steady net income in the years between. Call it a milk cow, Bessie, foster-mother to man over life, destined for sausage and shoe-leather on maturity. By assumption she neither appreciates nor depreciates throughout her life. She is much like a time deposit. The beauty of the Bessie model for tax analysis is the simplicity of defining income in the absence of depreciation and appreciation. The net current income is all income. There is no recovery of capital until her last day.

In this case a neutral tax results if the owner pays on current net income as received; and writes off capital cost in year  $m$  when he recovers it. Under this rule there is no tax on capital recovery, as with an excise tax, to penalize shorter maturities; nor any advance of write-off before recovery, as with expensing, to subsidize the investor and counteract the tax. The owner cannot avoid full taxation by turning to more long-lived Bessies, nor is he penalized if he jilts Bessie for Henrietta Hen, who yields a stream of eggs over a short life before broiling. At any life he bears the full tax, so  $r = i(1 - t)$ .

If we let him defer taxes on milk income until maturity, the case would be like that of the tree with a bias to longevity and a wide-open route to tax avoidance. That is not done explicitly although he can do it indirectly by feeding more milk to calves for future income, and even by dumping milk in quixotic milk strikes in hope of higher future income. If we let him write off Bessie before her time he would also pay a lower effective tax rate (and that we do do, explicitly). As with the tree, expensing (writing off Bessie's cost as business expenses) would afford full tax exemption: the yearly interest on write-off at time zero would pay the yearly tax on income (and the tax rebate on write-off itself would just cover the tax on realization of salvage value). As with the tree, the bias to longevity caused by write-off in an intermediate year,  $w$ , would depend on how  $w$  varied with  $m$ . In practice it would be biased to longevity because  $w$  tends to vary insufficiently with  $m$ . That is equally true whether  $w$  is actually a single year or something like the mean year of a depreciation schedule taken as the unitary equivalent of the whole schedule.

An undepreciating asset like Bessie should not be written off over life, therefore, because to do so in any feasible way creates an intra-class bias. The only reason for allowing it would be to reduce the inter-class bias in favor of trees and other appreciating assets. But that is not a good reason either because it would increase the inter-class bias against depreciating assets, the most common kind.

The Bessie model is of course artificial, rigid, and unlikely to exist in pure form. Its value is to highlight basic criteria which we may seek to apply to the more difficult case of depreciating assets to help find a timing of tax liability and write-off that is intertemporally neutral. These criteria are:

a. Tax income when it accrues, either as appreciated value (the tree case) or in cash payments.

b. Write off assets only when they depreciate (or are liquidated outright, which we include with "depreciate").

To summarize (a) and (b) tersely: tax cash receipts, deduct cash outlays; tax appreciation, deduct depreciation.

Let us now apply those principles to the more general case of depreciating assets and find a formula for intertemporal neutrality.

#### IV

##### Depreciating Assets

ASSETS THAT YIELD regular or intermittent incomes over life may be analyzed, and usually are, as though they were aggregates of point-input point-

output cases. That is, standard financial formulae for annuities are derived simply by summing up the present value of all the future payments, thus:

$$V_0 = \sum_1^l [a_n(1+i)^{-n}]$$

where  $l$  is life.

For a constant annuity of \$1 (beginning at the end of year zero)

$$V_0 = \frac{1 - (1+i)^{-l}}{i}$$

and all annuity formulae are variations of that.

We should expect, therefore, that our conclusions from the tree case should apply to the present more general case, as the Austrians alleged. But that is quite a transfer to take on faith, and even if one did, the details of the transfer would still pose several perplexities. So we now present a model of a depreciating asset, the impact of taxation, and the write-off schedule needed to avoid intertemporal bias.

Assume our asset costs \$1 at time zero and yields a constant cash flow (net of current costs, of course) over life of  $l$  years. It is a depreciating asset not because of falling income but because of falling life expectancy.<sup>30</sup> In equilibrium without taxes the cash flow is the annuity,  $a$ , whose present value is one:

$$a = \frac{i}{1 - (1+i)^{-l}}$$

a function tabulated in all interest tables. Sometimes it is called the "capital recovery" formula, because it returns a dollar of capital with interest at  $i$  per cent.

Now we levy an excise tax on this annuity. The taxpayer gets  $a(1-t)$ . His rate of return after tax,  $r$ , is now the capitalization rate that will give this reduced annuity a present value of one.

$$(9) \quad 1 = \frac{i}{1 - (1+i)^{-l}} (1-t) \frac{1 - (1+r)^{-l}}{r}$$

Table 2 is a numerical example from the interest tables showing that  $r$  rises with  $l$ .

Here, as in the point case, excise taxation without deduction of costs results in extreme bias against short lives, and for the same reason. Any tax rate higher than 8 per cent makes  $r$  negative for maturities of one year

<sup>30</sup> As we said in the introduction, we are treating here only this case and not the case of a falling income stream. The latter is comprehended in the general formula in the appendix.

or less. The 50 per cent rate of Table 2 makes  $r$  negative for maturities under 19 years.

Table 2  
RATE OF RETURN AFTER EXCISE TAX OF 50% ON ANNUITY  
WHOSE PRESENT VALUE AT 8% IS ONE (1)

$l$	$a = \frac{i}{1 - (1+i)^{-l}}$	$a(1-t) = \frac{1}{2} a = \frac{r}{1 - (1+r)^{-l}}$	$r$ %
1	1.080	.5400	-45.
5	.2505	.1253	-14.
10	.1490	.0745	- 5.
(19)	(.1041)	(.0521)	( 0 )
20	.1019	.510	.2
30	.0889	.0444	2.0
40	.0839	.0419	2.8
50	.0817	.0409	3.3

The case is so obvious from Table 2 that we dispense with graphical illustration and rigorous proof by differentiation. It is enough to solve (9) for  $r$  and inspect it:

$$(9a) \quad r = i(1-t) \left[ \frac{1 - (1+r)^{-l}}{1 - (1+i)^{-l}} \right]$$

When  $l = 1$ ,  $r = i(1-t) - t$  and  $r$  is negative for all  $t > \frac{i}{1+i}$ . But as  $l$  grows, the fraction in brackets approaches unity and  $r \rightarrow i(1-t)$ .

The interesting project now is to find a depreciation schedule that may free the tax of intertemporal bias. The Bessie case leads us to expect this is possible by writing off capital at the time recovered. The trick in the annuity case is to separate income from capital recovery.

The project involves four steps:

First, modify equation (9) to include the depreciation rebate.

Second, define true yearly depreciation as the drop in value of an asset.

Third, substitute the true depreciation into modified equation (9).

Fourth, show that  $r = i(1-t)$  for all lives,  $l$ , when true depreciation is allowed.

Beginning with the first, the taxpayer's  $r$  is now redefined to show the write-off:

$$(10) \quad 1 = \frac{i}{1 - (1+i)^{-l}} (1-t) \frac{1 - (1+r)^{-l}}{r} + t \sum_0^l \left[ d_w (1+r)^{-w} \right]$$

The last term is the tax rate times the present value of all depreciation

write-offs,  $d$ , in all years,  $w$ . The effect of adding a term to the right side is to raise the value of  $r$ , since now the investor can capitalize his after-tax annuity at a higher rate to make it equal \$1.

We use  $r$  rather than  $i$  to discount future  $d_w$  to present values in equation (10) because the original equation (9) was set up to define that  $r$  necessary to discount after-tax incomes to present values in order to make the sum equal the initial investment, one. That is what the first term on the right side of equation (10) does. Write-off rebates are just like another after-tax income payment at the date received, and discounting by  $r$  treats them parallel to other after-tax income.  $r$  is the discount rate that reduces the sum of all future after-tax payments, including write-off rebates, to \$1 [23, 339, Equation (14)–(17)].

Second, we define true yearly depreciation as the drop in value of an asset. Here is an asset yielding a steady annuity of  $a$  over  $l$  years and then ceasing abruptly. It depreciates not because of declining yearly income but declining life expectancy.<sup>30</sup> We might call it the one-hoss shay case but that would have only poetic value since new rolling stock tends in fact to fall rapidly in annual use-value, resulting in the typical ski-slope depreciation curve traced by Blue Book values of used cars. The present case is more the slum tenement which with advancing years is sub-divided, maintaining gross income, but accelerating depreciation, until one day it is condemned and closed, or perhaps demolished due to locational obsolescence.<sup>31</sup>

The present value of this model slum tenement is the sum of the discounted values of all future incomes:

$$(11) \quad V_0 = a_1(1+i)^{-1} + a_2(1+i)^{-2} + \dots + a_l(1+i)^{-l}$$

The passage of year zero does not reduce its value much. It might seem at first that  $V_0$  would fall by the loss of the first term  $a_1(1+i)^{-1}$ , which is the largest term. But that is to reckon without the appreciation of all the later terms which move one year closer to the present. When all the  $a$  values are the same, the end result is to remove the last term, not the first.

<sup>30</sup> Once again, see fn. 30.

<sup>31</sup> Thanks go to Dr. Herbert Dorau, who has let the writer examine his unpublished *Integration of the Straight Line Accrual* in which he treats building depreciation in much the manner that we do here. Earl Bossard has used this method in forecasting the property tax base of Shaker Heights [36, 43].

Philip Stern points out that this pattern of building depreciation is implicit in repayment patterns on mortgage loans in equal monthly installments. If buildings depreciated like cars, owners would soon have no equity and lenders would have insufficient collateral security [33, 152–53]. Frederick Babcock's classical *Valuation of Real Estate* also treats depreciation essentially in this manner (chap. 27).

Thus:

$$(12) \quad d = V_0 - V_1 = a(1+i)^{-1} - i \left[ a \frac{1 - (1+i)^{-1}}{i} - a(1+i)^{-1} \right] \\ = a(1+i)^{-1} [1+i] - a [1 - (1+i)^{-1}] = a(1+i)^{-1}$$

As a counterpart and confirmation of this definition of depreciation, note what it implies about the value of income,  $a - d$ .<sup>32</sup>

$$(13) \quad Y \equiv a - d = a - a(1+i)^{-1} = a[1 - (1+i)^{-1}]$$

But

$$V_0 = a \frac{1 - (1+i)^{-1}}{i}$$

$$\therefore Y = V \cdot i.$$

Income is defined now simply as interest on the remaining value of the asset, a credible notion in its own right. In early years when value is high, the cash flow is mostly income, with only a small depreciation write-off; in later years the cash flow is mostly depreciation. This also accords nicely with the observed fact that older buildings usually pass into high density use, occupied by lower status tenants who tend to have higher propensity to wear and tear in using the premises.

The acute reader will have noted that our definition of income now leads directly to the conclusion of making the income tax bear on buildings in the same time pattern as the property tax: high in early years, low in later years, taking always a constant share of a base which varies directly with the capital value. This harmonizes with our conclusion about the tax on timber, and is subject to the same severe qualification. The tax on buildings, is a damaging tax. Hardly anyone has a good word for it, least of all the present writer. But it is visibly damaging precisely because it does what it is alleged to do, it taxes the possession of capital and is not avoidable, save by emigration. If the income tax is less damaging it is not because it is a better way to tax property, but a way to let property avoid taxes and shift more burden to labor. In the process of avoidance, capital twists and contorts itself into uneconomic time-patterns, abandoning urgent needs and superior before-tax returns to sequester itself in an inadequate number of excessively durable buildings.

Having defined true depreciation, we have completed Step 2 of this project. That brings us to Step 3, which is substituting true depreciation into Equation (10). This is a delicate stage of the operation. We must sum the elements of the present value of depreciation in one simple expression. There are several points where one misstep would ruin the whole job.

A touchy matter is to get the end points right.<sup>33</sup> Depreciation during

<sup>32</sup> Credit is due to Professor Samuel Thorndike, Jr., for raising this point.

<sup>33</sup> Thanks are due to Professor Robert San Souci for repeated emphasis on this as the

the first year of life is, we have shown,  $a(1+i)^{-1}$ , representing the loss of the present value of  $a$ , (the  $a$  due at the end of the last year,  $l$ .) Succeeding discount powers would fall by one each year, giving exponents of  $1-l$ ,  $2-l$ ,  $3-l$ , etc. The last term is not, however, raised to the power  $1-l$  or 0, but rather  $-l$ , or  $1-l-1$ . Because depreciation during the last year of life cannot be the full value of  $a$ , which by assumption is received at the end of the year. The value of the asset at the beginning of the year is  $a(1+i)^{-l}$ , and that, obviously, is all there is left to depreciate during year  $l$ .

In general, then, for any year  $n$ , the depreciation is  $a(1+i)^{n-1-1}$  [23, 341].

A close look at year  $l$  also tells us why we use  $i$  rather than  $r$  to define depreciation. Income in year  $l$  is now  $a - a(1+i)^{-1} = a(1 - (1+i)^{-1}) = [a(1+i)^{-1}]i$ . That is, income is interest on the value of the asset when the year began. Now, this income is our tax base. If we used  $r$  instead of  $i$  to define it, the tax base would be the after-tax income, an obvious error.<sup>34</sup>

It might seem that the market value of the asset at the beginning of year  $l$  would be  $a(1+r)^{-1}$ , making our depreciation schedule arbitrary, and departing from market values which would be set by discounting at  $r$ . But remember there are two tolls to pay for passage through the year: after-tax interest,  $r$ , and also taxes themselves. To be worth a price  $\pi$  on January 1, our asset maturing on December 31 must return not just  $\pi + \pi r$ ; but also  $\pi i$  to pay taxes. But  $r + i = i$ , so  $\pi(1+r+i) = \pi(1+i)$ . From that it follows directly that  $\pi = a(1+i)^{-1}$ , where  $a$  is a payment due at year-end.

The rate the taxpayer uses for discounting future write-off rebates is, however,  $r$ , as in Equation (10). That is because the rebates are his without additional taxes.

Now we may find the present value of all write-offs, PVW, for substitution in Equation (10).

$$(14) \quad \text{PVW} = a \left[ \frac{(1+i)^{-1}}{(1+r)} + \frac{(1+i)^{1-1}}{(1+r)^2} + \dots + \frac{(1+i)^{-1}}{(1+r)^l} \right]$$

The brackets enclose a geometric progression whose first term is  $\frac{(1+i)^{-1}}{(1+r)}$ , whose multiplier is  $\frac{1+i}{1+r}$ , and whose terms number  $l$ .

<sup>34</sup> We believe that Professor Musgrave falls into this error in his definition of the "annuity method" [23, 341]. It is perhaps this which prevented his finding a general solution.

$$(14a) \quad \frac{PVW}{a} = \frac{(1+i)^{-l}}{1+r} \cdot \frac{1 - \left[ \frac{1+i}{1+r} \right]^l}{1 - \frac{1+i}{1+r}} = \frac{(1+i)^{-l} - (1+r)^{-l}}{r-i}$$

Substituting (14a) in (10)

$$(10a) \quad 1 = a(1-t) \frac{1 - (1+r)^{-l}}{r} + ta \frac{(1+i)^{-l} - (1+r)^{-l}}{r-i}$$

$$\text{Recall that } a = \frac{i}{1 - (1+i)^{-l}}$$

$$\frac{1 - (1+i)^{-l}}{i} = (1-t) \frac{1 - (1+r)^{-l}}{r} + t \frac{(1+i)^{-l} - (1+r)^{-l}}{r-i}$$

Now to Step 4: does  $r$  vary with life,  $l$ ?

Equation (10a) is too formidable to solve directly for  $r$ . Fortunately there is an easier way. We simply test a hypothesis: is the equation satisfied if  $r = i(1-t)$ ? A few substitutions and cancellations answer the question.

$$(10b) \quad \frac{1 - (1+i)^{-l}}{i} \stackrel{?}{=} (1-t) \frac{1 - (1+r)^{-l}}{i(1-t)} + t \frac{(1+i)^{-l} - (1+r)^{-l}}{i - it - i}$$

$$\frac{1 - (1+i)^{-l}}{i} \stackrel{?}{=} \frac{1 - (1+r)^{-l}}{i} - \frac{(1+i)^{-l} - (1+r)^{-l}}{i}$$

$$0 = 0$$

(10b) is true for all values of  $l$ . This means that the use of true depreciation as the basis for tax write-off gives us an income tax that is free of intertemporal bias. The taxpayer's yearly rate of return is reduced by the full tax rate, regardless of the life of his investment.

This completes the fourth and last step of the operation. We have discovered that the income tax on depreciating assets may be freed of intertemporal bias by writing off capital at the time it is recovered. This reinforces our earlier findings for appreciating assets like trees and full salvage assets like the Bessie model. By following the simple rules of taxing appreciation and deducting depreciation we not only make the tax neutral within each class but also among classes, for in all cases the rules make  $r = i(1-t)$ .

The result is of practical interest as a benchmark against which to judge present write-off formulae. It is even more interesting as a practical reform proposal in its own right, because it is operational. It is simply the ad valorem property tax! The basic rules to follow are simple. It may have appeared complicated to prove that the rules led to unbiased results, but applying the rules poses no such problem. It is even simpler

than following market depreciation downwards, or appreciation upwards. The practical "operationality" of our system may be better appreciated by realizing it does not call for a fine appraisal of each year's change in asset value, an apparent practical barrier that has dampened the ardor of some theoretical supporters. Rather, it defines income as a percentage of asset value, so that one capital value is all we need to know, as with the property tax, and an assessed approximation is tolerably acceptable. We will see that this principle holds as well for appreciating land values. Yearly reassessment is best, but not absolutely essential for a workable system. The idea is, if we know the market value we know how to allocate cash flow between income and depreciation, not perfectly, but much better than under any of the arbitrary formulae now in use.

To criticize our method, as some will, on the grounds that property appraisal is impracticable, would be merely captious, because all systems of taxing property income require property appraisal at some critical points. Furthermore, if property appraisal is impractical it is not just taxation but the free market mechanism that stands condemned, for how else do people buy and pledge property?

We have not as yet produced a completely general proof. However, we will from here on regard the proposition as proven, for three reasons: (1) it is proven for point-input point-output, and all cases are summations of point cases; (2) we have illustrated the proof in two models which were summations of point cases; and (3) we provide a completely general mathematical proof in an appendix.<sup>35</sup>

Now we are in a position to see clearly some further biases to longevity inherent in current income tax practice. If an asset yielding a constant annuity like our slum tenement model were to receive straight line depreciation, that would be too fast. True depreciation begins low and rises like a compound interest curve. Figure 2 points up the contrast. Granting straight line depreciation on the asset writes it off at a faster rate than the true one and therefore raises  $r$  above  $i(1 - t)$ .

The resulting bias to longevity inside the subclass of tenement models (i.e. constant finite annuities) is only moderate. In the appendix we show how  $r$  varies with  $l$ , under straight line depreciation applied to an annuity.

But the bias is much greater if we compare constant annuities with assets yielding declining streams of income, like trucks. Their true

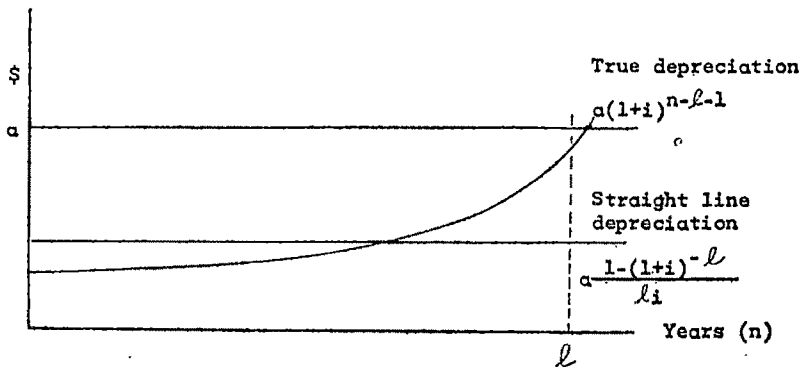
<sup>35</sup> Professor Musgrave has worked through an arithmetic example leading toward conclusions consistent with ours [23, 340]. His treatment is limited, however, to one case of straight line depreciation. We do not know what his position would be on our allegation that a neutral income tax is the property tax.

depreciation is much faster than the tenement model's, even assuming equal total lives. But here we again run afoul of lawyers who think in categories and not continua. In tax law, "pigs is pigs"<sup>86</sup> and "life is life," the number of years between birth and scrapping,<sup>87</sup> so trucks and tenements of the same "life" would be written off at the same rate regardless of the faster true depreciation of the trucks. This tends to make tenements relatively more attractive after tax than before. Trucks might very well end up yielding an  $r < i(1-t)$ ; and that would obviously be so if, for example, half the value were recovered in one year and write-off took ten. Tax liability would then precede the mean write-off by five years.

In general, arbitrary write-off schedules based on "life" favor assets yielding steady or rising income streams and penalize their opposite numbers yielding falling income streams. Thus they encourage investors to build more durability into assets than they would in the absence of taxes; and they open a wide avenue of tax avoidance.

Figure 2

True depreciation and straight line depreciation for an asset yielding a constant annuity over life



<sup>86</sup> For the benefit of younger readers, the allusion is to a tale by Ellis Parker Butler wherein a narrow-gauged freight agent insists on shipping Guinea Pigs at the Swine rate.

<sup>87</sup> More realistically, between birth and statute life, based on broad guidelines depending on the category in which the asset's legal name places it, and only remotely related to economic life of the particular asset.

It is not just lawyers who may fall into this error. The Chairman of the President's Council of Economic Advisors, in L. B. Johnson's Administration, in seeking to deny that capital-intensity implies durability of capital instruments, makes his case with an example in which he alleges that three methods of production all involve capital of the same "life" because the fixed capital lasts for 10 years in each method. But the lives are the same only in the most superficial sense because they use different amounts of working capital. G. Ackley, *Macroeconomic Theory* [1, 467-69].

In fact, the tax laws have moved towards tax exemption for durable capital by accelerated depreciation, capital gains treatment, declining balance depreciation, sum of the years' digits, the investment tax credit, expensing of some durable investments, implicit expensing through allocating owned resources to building durable capital, (extra-legal) use of expensable hired resources to build durable capital, super-accelerated write-off for buildings placed on leased land, etc. In the abstract, these devices could benefit short maturities as much as long. In practice they usually benefit the long. First, they are mostly reserved for assets more long-lived than specified minimum lives;<sup>38</sup> second, they tend to make write-off schedules more and more independent of actual lives and time-patterns of income streams.

In addition, as everyone knows and most economists deplore, use of the realized-cash definition of income exempts altogether the implicit income from owner-occupied residences and other consumer capital. This creates in the income tax an additional bias to longevity. Of course short-lived consumer capital benefits as much as long from this exemption. The bias to longevity comes because the individual piling up tax-exempt consumer capital has to reduce its turnover rate to avoid increasing his rate of real consumption. Also, he now discounts future implicit income at the lower after-tax rate of return,  $r$ , which favors longer lived investments.

These various practices are not without short run macro-economic benefits. They raise the marginal efficiency of capital and encourage net new investment. They let capital avoid taxation at home and prevent its flight overseas. But they do so at a fearful price. They shift the burden of taxes from property to labor (land escaping also by various ruses we have mentioned and others yet to be shown). They misallocate capital into more long-lived forms than would best meet consumer demands. And they retard replacement in all future years, lowering gross investment in any year and thus lowering the sum of income-creating expenditures and the demand for labor.

(Continued)

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<sup>38</sup> For example, Congress in 1962 plugged a loophole by denying to personal property the privilege of capital gains treatment on the excess of sale value over book value resulting from excessive depreciation—but let real estate retain the privilege [33, 153]. Recapture of excess sale values is at a sliding scale of rates that declines with the period of time a building is held [33, 155-56]. The idea seems to be that long term investors are "legitimate," while others are "fast-buck artists." We think that the fast buck is socially superior to the slow one.

Congress' special partiality for real estate investors shows up again in the 1960 law letting Real Estate Investment Trusts deduct their *dividends* (sic) from taxable income.

*The Problem of Human Destiny*

OF THE GREAT BRANCHES of knowledge, the sciences, the social sciences, and the humanities, the sciences are applied, sometimes almost as soon as they are learned. Strenuous and occasionally successful efforts are being made to apply the social sciences, but almost never are the humanities well applied. We do not use philosophy in defining our conduct. We do not use literature as a source of real and vicarious experience to save us the trouble of living every life again in our own.

The great tasks of the university in the next generation are to search the past to form the future, to begin an earnest search for a new and relevant set of values . . . and finally to learn how to use all the knowledge we have for all the questions that come before us.

I have some suggestions . . . I would take about a fourth of the student's time throughout the undergraduate years and organize it into courses which I would call history, and literature, and philosophy, and anything else that seemed appropriate and organize these courses around first-rate problems. . . .

One first-rate problem, for instance, is that of interfering with what some call human destiny, and others call biological development of the human individual, which is partly the result of genetic circumstances and partly the result of accidental environmental conditions. . . .

Now it is anticipated that the next generation, and perhaps this one, will be able to interfere chemically with the actual development of an individual and perhaps biologically by interfering with his genes. We have a long history of speculation going back to antiquity on the consequences. There are first-rate ethical, moral and philosophical implications to interfering with human development. Obviously, there would be benefits both to individuals and to society from eliminating, or at least improving, mentally and physically deformed persons.

On the other hand, there could be very serious consequences if this knowledge were used with premeditation to produce superior and subordinate classes, each genetically prepared to carry out a predetermined mission. Both Aldous Huxley and I suspect that this can be done. What happens then to free will, to democracy, and to the rights of the individual? Human destiny is a first-rate scientific, philosophical, and moral problem today. It will still be a first-rate problem when all of us are dead. [From an address by the Chairman of the National Endowment for the Humanities.]

BARNABY C. KEENEY

## Proudhon's Sociology of War

By AARON NOLAND

"WAR," GASTON BOUTHOUŁ AFFIRMED in his book *La Guerre* (1953), "is uncontestably the most spectacular of all social phenomena . . . the most energetic and efficacious form of contact between civilizations" and "the most remarkable of all *les formes de passage* of social life."<sup>1</sup> As this estimation of the central role of military conflict in history and the life of society has been a traditional one, reaching back in western civilization at least as far as classical Greece, it is not surprising that war has been continuously subject to study by sociologists and other students of social phenomena. The 19th century was particularly rich in such studies. Among those who made contributions were socialists of differing hues and schools, such as the Saint-Simonians and Marxists. Although the theories of war of some of these socialists have been subject to scholarly study,<sup>2</sup> the important writings on war of the father of modern anarcho-socialism and the rival of Karl Marx, Pierre-Joseph Proudhon (1809-1865), has received relatively little serious attention.<sup>3</sup> The purpose of this paper is to present succinctly Proudhon's sociology of war in order that his contribution may receive recognition.

At the outset Proudhon's distinctive approach to the study of war can be brought sharply into focus by contrasting it with the writings on the subject by some of the leading French socialist theoreticians of his own day—men like Louis Blanc, Victor Considérant, and Constantin Pecqueur. Their overarching view of war was that it constituted a heinous crime against humanity, a scourge and a calamity, an aberration and abnormal social manifestation. They held that it was wasteful of human and material resources, and an immoral phenomenon incompatible with human dignity and values and the progress of mankind.<sup>4</sup> Louis Blanc put it this way in 1878:

<sup>1</sup> *Loc. cit.*, Paris, pp. 5 and 6. See also Bouthoul, *Les Guerres: éléments de polémologie* (Paris, 1951), p. 5. The author wishes to acknowledge his indebtedness to the American Council of Learned Societies for a grant which enabled him to prepare this study; thanks are also due to Hilda Lobsenz and Pearl Noland for valuable research assistance.

<sup>2</sup> See, for example, Edmund Silberner, *The Problem of War in Nineteenth Century Economic Thought* (Princeton, 1946), pp. 213-79, 320-24; Sigmund Neumann, "Engels and Marx: Military Concepts of the Social Revolutionaries," *Makers of Modern Strategy*, ed. Edward M. Earle (Princeton, 1943), pp. 155-71; Leo A. Joubère, "Les Idées de Louis Blanc sur le nationalisme, le colonialisme et la guerre," *Revue d'histoire moderne et contemporaine*, Vol. 4 (1957), pp. 33-63.

<sup>3</sup> For biographical details on Proudhon, see George Woodcock, *Pierre-Joseph Proudhon, A Biography* (New York, 1956); Edouard Dolléans, *Proudhon* (Paris, 1948).

<sup>4</sup> Silberner, *The Problem of War*, pp. 213-35, 249, 288, 297. See also François Vidal, *Vivre en Travaillant* (Paris, 1848), p. 253; Pierre Leroux, *Oeuvres* (Paris, 1850), Vol. I, pp. 271-56, 275-56. I am indebted to Pearl Noland for the last reference.

The slaughter of several thousands of men, the despair of their mothers and wives, the distress of their children, the depopulation of the countryside, the abandonment of agriculture, the paralyzing of industry and commerce, the undue growth of taxes, all this is the balance, not only of defeat, but of victory. To the ignoble cry "Woe to the vanquished!" history makes this avenging reply: "Woe to the victors!"<sup>5</sup>

Proudhon's approach to war contrasted sharply with that of his socialist contemporaries. Proudhon did recognize, as will be indicated, that war exacted a heavy toll in lives and resources but that this in no way detracted from the positive and indispensable role it played in the life of society and in the history of civilization. "War, in one form or another," he wrote in 1861, "is essential to our humanity;" it "is inherent in humanity," as much a function of civilization as of the state of barbarism," and "the most grandiose manifestation of our individual and social life." To Proudhon, war has constituted "the most profound, the most sublime phenomenon of our moral life . . . the most incorruptible expression of our conscience." The same conscience

which produces religion and justice produces war as well; the same fervor, the same spontaneous enthusiasm which animates the prophets and *les justiciers*, moves its heroes; it is this which constitutes the *caractère de divinité* of war.

War is "essentially *justicière* and *juridique*" in character, for it has been an agency through which justice has found expression and affirmation in the world. For this reason "war is legitimate in its essence, saintly and sacred . . . heroic and divine . . . the summit of human virtue." Moreover, he goes on, war has been the mother of societies and nations, of the arts and sciences. War "is quite normal, glorious, and fecund," "a divine fact, *sublime et sainté*," necessary for "the education of the human race" and the advancement of humanity. "The purpose of war, its role in humanity," Proudhon declared, "is to provide the impetus to all the faculties of man, to universalize right (*le droit*), and, with the aid of this universalization of right, to define and motivate society." Far from joining his socialist compatriots in denouncing it, Proudhon called for a 'salute' to war in all its glory and fecundity:

Hail to war! It is through war that man has painfully emerged from the mire which constituted his original *milieu* and has taken up his stance of dignity and valor. It was over the corpse of a defeated enemy that man first conceived his dream of glory and immortality. This outpouring of blood, these fratricidal carnages outrage our men of philanthropic sentiments. I fear that this flabbiness indicates an attenuation of our virtue.

<sup>5</sup> Quoted in Silberman, *The Problem of War*, pp. 233-34. On Blanc's pre-1848 bellicosity and pro-war stance, see Loubère, "Les Idées de Louis Blanc," *loc. cit.*, pp. 49-62 *passim*; *idem*, *Louis Blanc* (Evanston, 1961), pp. 51-53.

To maintain a sublime cause in an heroic struggle where the *honorabilité* and the presumption of right of the combatants are equal—what is so terrible about this? Above all, wherein lies the immorality? Death is the very peak, the crowning (*le couronnement*) of life: could there be a more noble end for a man, this intelligent, moral, and free being?<sup>6</sup>

In 1861 a two-volume work by Proudhon was published in Paris, entitled *La Guerre et la paix*, which embodied the above sentiments and expounded at length what Proudhon identified as a 'phenomonology' or sociology of war. The response accorded the work by a significantly large section of the press and the reading public, at the time of publication and after—indeed to our own day—was compounded of outrage, bewilderment, dismay, and disbelief. In glorifying war with its carnage, in his panegyric à outrance on war, Proudhon, some wrote, was seeking to shock a public that was growing increasingly receptive to pacifism and internationalism—to provoke public opinion as he had in earlier works when he affirmed that "Property is Theft" and "God is Evil."

Others declared that Proudhon's study was prolix, confused, full of contradictions, illogical, and in no sense a well-reasoned and researched scholarly effort. To many it appeared incomprehensible and rather absurd, that anyone who claimed, as Proudhon certainly did, to be a socialist and a revolutionary would expound bellicose, martial views that were worthy of a 'reactionary' like Joseph de Maistre. Some critics refused to take the work seriously, contending that it was a hoax and/or that Proudhon was a madman of sorts.<sup>7</sup>

That there is some basis for many of these judgments can hardly be denied by anyone who has read *La Guerre et la paix*. Certainly the work is not well organized and is full of digressions. Proudhon's love of the paradox, his penchant for the arresting phrase, his failure to define his terms rigorously or to employ them consistently—all this does tend to confuse the main line of his argument. There are lacunas, non sequiturs, and bizarre assertions; and Proudhon often cites with approval de Maistre,

<sup>6</sup> Proudhon, *La Guerre et la paix* (Paris, 1927; first edition, 1861), pp. 30, 31, 14, 22, 29, 32, 55, 56, 70, 75, 196, 197, 217, 432, 439, 468, 478, 489-90.

<sup>7</sup> See Henri Moysses's introduction to *La Guerre et la paix*, pp. xxxii-xxxiv; Théodore Ruysen, "La Guerre et la paix," *Le Contrat social*, Vol. 5 (March-April 1961), p. 100; Charles Richet, *Le Passé de la guerre et l'avenir de la paix* (Paris, 1907), pp. 96-97. Quincy Wright, in his classic *A Study of War* (2nd ed., Chicago, 1965), does not deal with Proudhon's theory of war, but simply links Proudhon with Nietzsche and Clausewitz as a "believer in violence" (pp. 436, 1215). D. W. Brogan, citing Proudhon's *La Guerre et la paix*, writes that there are "passages to the glory of war which would be in place in a speech by Herr von Papen" (*Proudhon* [London, 1934], p. 77); and Edouard Berth, Georges Sorel's leading disciple, called Proudhon's book "la plus magnifique apothéose de la guerre qu'on ait jamais faite" ("the most magnificent glorification of war ever written"). "Proudhon en Sorbonne," *L'Indépendance*, Vol. 27 (1912), p. 134. See also Roger Caillois, *Bellone, ou la pente de la guerre* (Paris, 1963), p. 159.

Hegel, and Hobbes, not always with a clear understanding of what these men had written nor in the appropriate context. Nevertheless, these shortcomings do not render the work incomprehensible and valueless, nor do they prove the work to be a hoax. *La Guerre et la paix* is, in spite of its defects and inadequacies, essentially what Proudhon claimed that it was—a serious attempt to anchor the phenomenon of war within a general theory of society and of historical change and development, to account for war as a recurrent and 'normal' manifestation of contending social forces in specific historical circumstances and at a particular stage of the development of civilization.<sup>8</sup>

Proudhon's theory of war is directly related to, and indeed can only be comprehended within the framework of his overarching view of nature, man, and society. To him the three are linked in an inseparable manner, constituting as they do different aspects of a single reality. The universe, in Proudhon's view, is a Heraclitean one in which "nothing remains the same, in which everything changes, flows, and is in a state of becoming"—a universe in which "everything relates to everything else, is linked up with it; consequently, everything is in mutual opposition, balance, and equilibrium." The incessant movement and change which characterizes the universe is, in Proudhon's words, "the eternal dance" of life; and in his description of it such words as struggle, conflict, contradiction, antinomy, disharmony, equilibrium, tension, and reconciliation appear again and again. These are the processes and elements that make up "*la véritable constitution de l'univers*."<sup>9</sup>

The life of man, in Proudhon's view, is also "*une solution d'antinomies sans fin*," since man is himself "an illogical and contradictory being . . . an inharmonious creature, an incoherent assemblage." Man is composed at one and the same time of "spirit and matter, spontaneity and reflection"—he is "an automaton and a free being, an angel and a brute," an "animal"

<sup>8</sup> See Célestin Bouglé, *La Sociologie de Proudhon* (Paris, 1911), pp. 257-95; Jeanne Duprat, "La Conception proudhonienne des facteurs économiques de la guerre et de la paix," *Revue internationale de sociologie*, Vol. 37 (1929), pp. 143-72; J.-L. Peuch, "Proudhon et la guerre," *Proudhon et notre temps* (Paris, 1920), pp. 203-38; Edouard Dolléans, "La Guerre et la paix d'après Proudhon," *La NEF*, Vol. 3 (July 1946), pp. 74-78, John U. Nef, *War and Human Progress* (Cambridge, Mass., 1950), p. 405.

<sup>9</sup> Proudhon, *Philosophie du progrès* (Paris, 1946), pp. 42, 49-50, 56, 115; *idem*, *La Guerre et la paix*, pp. 63, 64, 68, 71, 184, 477-79, 482; *idem*, *De la Justice dans la révolution et dans l'église* (Paris, 1930), Vol. 1, pp. 232, 233; Vol. 3, pp. 405, 406, 452, 511; *idem*, *Système des contradictions économiques* (Paris, 1923), Vol. I, pp. 98-100; Vol. II, pp. 289-90, 396, 397; *idem*, *Théorie de la propriété* (Paris, 1866), pp. 206, 213; *Carnets de P.-J. Proudhon*, ed. Pierre Haubtmann (Paris, 1961), Vol. I, pp. 140, 207-08, 257, 259-60; Vol. II, pp. 242, 243, 269. In this section of the paper, I have used material presented in my article "History and Humanity: The Proudhonian Vision," *The Uses of History*, ed. H. V. White (Detroit, 1968), pp. 59-105.

made up of antinomies and contradictions, love and hate—in truth, “*un animal désordonné*.”<sup>10</sup> Hence, in the primeval state of nature in which mankind—this “*exécrable espèce humaine*”—originally existed, the life of man was “a state of war, as Hobbes has said . . . a permanent war—war against his needs, against nature, against his fellow men, and consequently, war against himself.” In this early state of nature, man was a miserable being, “an ugly and ignoble creature” who “wallowed endlessly in misery and brutality.”<sup>11</sup>

While man was an animal, he was, Proudhon insisted, following Aristotle, an animal of a particular sort—a “social animal,” whose destiny it was to live in society. On the one hand each individual was “at war” with his fellow men. At the same time he was “moved by an internal attraction towards other individuals”—“moved by a secret sympathy” which he could not resist without denying “his own nature,” for man’s “social needs” were complex and imperative. It was as a consequence of the “sympathetic attraction which causes men to associate,” an attraction which was, like man’s need to struggle, “blind and unruly” and ultimately “mysterious” in its nature, that the first more or less stable groupings of individuals came into being, groupings or collectivities of men and their families that in time founded the first societies.<sup>12</sup>

Proudhon contended that these groups or collectivities, together with the simple societies they forshadowed, bore the marks of their origins and reflected the character of their constituent elements. That is to say, like the universe and like individuals, they were composed of antagonistic forces in movement, with the life of the groups and societies characterized by a dialectic of oppositions, reconciliations, antinomies, equilibriums, clashes, and accommodations, incessantly in a state of flux and endlessly modifying their forms and structures both within each particular group, collectivity, and society and amongst them all. Each of these social forma-

<sup>10</sup> Proudhon, *Système des contradictions économiques*, Vol. I, pp. 371, 349–51, 358–60, 366–68, 383, 391, 397; Vol. II, pp. 87, 290, 409; *idem*, *De la Justice*, Vol. III, pp. 407–28 *passim*; *idem*, *Les Confessions d'un révolutionnaire* (Paris, 1929), p. 214; *Carnets de P.-J. Proudhon*, Vol. I, pp. 212, 207–08.

<sup>11</sup> Proudhon, *Système des contradictions économiques*, Vol. I, p. 219; Proudhon’s unpublished manuscript, “Le Cours d’économie,” *Feuilleton* Vol. 12, Nos. 1–3 and *Feuilleton* Vol. 18, No. 13, quoted in Pierre Hauptmann’s unpublished thesis “La Philosophie Sociale de P.-J. Proudhon,” (Sorbonne: Bibliothèque de l’Université de Paris, W 1961–5) pp. 166–67; *Carnets de P.-J. Proudhon*, Vol. I, pp. 131–32, 158; Vol. II, p. 291; Proudhon, *La Guerre et la paix*, pp. 35, 45, 56, 63, 70, 426, 477, 478, 496. In this book Proudhon frequently refers to “l’antagonisme que nous appelons la loi de l’humanité” (p. 482). See also *idem*, *op. cit.*, pp. 171, 55, 66.

<sup>12</sup> Proudhon, *Qu’est-ce que la propriété?* (Paris, 1926), pp. 299–313 *passim*, 321–24, 239–40; *idem*, *De la Célébration du dimanche* (Paris, 1926), pp. 40–41, 89; *idem*, *Les Confessions*, p. 220; *Carnets de P.-J. Proudhon*, Vol. I, p. 139; Proudhon, *De la Justice*, Vol. III, p. 519.

tions was the Heraclitean universe writ small.<sup>13</sup> In *La Guerre et la paix* Proudhon declared that conflict, antagonism was "the law of social life" as it was "the universal law of nature and humanity."<sup>14</sup>

It is at this point in the history of mankind—the coming into being of social groups—that war as a *specific form* of the universal antagonism and conflict of forces makes its appearance. Contacts between groups and incipient societies, Proudhon noted, produced clashes over rival claims to territory. For a tendency to expand holdings and to incorporate neighboring peoples was, in his view, a natural, inherent characteristic of such collectivities. Proudhon traced the emergence of such clashes in the following manner. Groups of families and tribes existed in isolation from one another in a large territory, "in the midst of immense forests, in a large valley, living and multiplying during a long period of time independently of one another." As these groups increased in size they formed "small states, which soon, obeying the law of expansion, extended themselves until contact with other such states was established." At first, this contact involved such matters as the determination of boundaries, which could be resolved with relative ease. But in time, with the continuing expansion of these initially small states, the area of maneuverability and accommodation amongst them was reduced. It then became necessary for the many small states to consolidate themselves to produce a small number of large states. For "the majority of these *Etats microscopiques* this involved the loss of individuality and independence." Now the questions were posed: which state is to be incorporated in another, which is to lose its identity, which state "shall give to others its name, law, language, and gods?" "*Où sera le foyer d'absorption?*"<sup>15</sup> In the absence of a superior authority to decide which states will continue to exist and which will be absorbed, how is the matter to be resolved?

Proudhon's answer is that, historically, such confrontations were resolved by an appeal to "*le droit de la force*," the right of force or strength<sup>16</sup>

<sup>13</sup> Proudhon, *La Guerre et la paix*, pp. 35, 44, 55, 63–64, 92, 101, 426, 486, 496; *idem*, *Mélanges: articles de journaux, 1848–1852* (Paris, 1869), Vol. II, p. 164; *idem*, *Système des contradictions économiques*, Vol. I, pp. 391–98 *passim*; *idem*, *Les Démocrates assermentés* (Paris, 1952), p. 39; *Carnets de P.-J. Proudhon*, Vol. II, pp. 242, 243, 269; *Correspondance de P.-J. Proudhon* (Paris, 1875), Vol. V, letter to Madier-Montjau, Nov. 10, 1852, p. 83.

<sup>14</sup> Pp. 184, 482, 477.

<sup>15</sup> Proudhon, *La Guerre et la paix*, pp. 221–22.

<sup>16</sup> "Right (*le droit*), generally speaking, is the recognition of human dignity in all its faculties, attributes, and prerogatives. There are, therefore, as many special rights as there are human attributes or the diversity of human faculties and their employment. The genealogy of these rights, consequently, follows that of human attributes and their manifestations. The right of force is the most simple of all rights and the most elementary—it is the homage rendered a man in consequence of his force or strength. . . . Also,

which finds expression in war "in which there is necessarily the shedding of blood, the squandering of wealth, the sacrifice of a nationality; but which, after all, from the elevated point of view of international law and progress, is nothing more than *un acte judiciaire*." Proudhon recognized that "this bloody justice is repugnant to us"; nevertheless, it is "essentially rational, honorable, and legitimate," for the right to command was anchored in that nationality or people which proved itself to be the strongest and the most spirited and which "through work, genius, the organization of power, and the practice of *droit*" possessed a superior degree of political competence. As Proudhon conceived of it, force, in a people, not only involved such considerations as the number of men and their physical strength, but also "faculties of the soul, courage, virtue, discipline, accumulated wealth, and the productive capacity of the nation." At that period in history when the formation of great States becomes inevitable, "it is the privilege of force" to indicate these states and to provide them with their constituent elements.<sup>17</sup>

It is war, therefore, that plays the central role in the creation of states and in their development, determining which are to survive and expand and which are to be absorbed following a "judgment" of arms. War, as an expression of the right of force, itself "the first and most irrefutable of rights," was, therefore, to Proudhon, "progressive and conservative . . . the first form of justice in society . . . legitimate in its essence, *sainte et sacrée*," and the dynamic element "which animates society" and which "has made it what it is."<sup>18</sup>

Now, in Proudhon's conception of history and his philosophy of civilization, the creation of the first states was a most momentous event, the crucial turning point in the history of humanity. It altered in an irrevocable manner the existential status of mankind by bringing to an end

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there is a right of work (*droit du travail*), in virtue of which all the product of human industry belongs to the producer . . . ; a right of intelligence (*droit de l'intelligence*), which entitles a man to think as he will and to instruct himself, to believe what he takes to be the truth and to reject what appears to him to be false . . . ; a right of love (*droit de l'amour*), which consists . . . of the fact that love, by its nature, involves for the lovers certain reciprocal obligations . . . ; a right of seniority (*droit de l'ancienneté*), which requires that on equal merit the longest service receives supreme ranking (*la supériorité du grade*)" (*ibid.*, pp. 183, 128-29). See also *Correspondance de P.-J. Proudhon*, Vol. XII, letter to Clerc, March 16, 1863, pp. 368-69; Proudhon, *De la Justice*, Vol. IV, p. 199.

<sup>17</sup> Pp. 222, 223. That Proudhon's notion of the right of force bears a close resemblance to some varieties of "Social Darwinism" has been noted by students of his thought. See Moyssset's introduction to *La Guerre et la paix*, p. lxxi.

<sup>18</sup> *Ibid.*, pp. 57, 75, 90, 194, 312. "There is in war a moral element. War is a judicial act, and of all the forms of justice it is the most sublime, incorruptible, and the most solemn" (*ibid.*, p. 196).

the infancy of mankind and initiated its long, painful, yet inevitable ascent towards self-consciousness, maturity, and the fulfillment of its destiny. As noted, Proudhon contended that conflict, antagonism, tension, etc., were inherent in man and in society, just as they were structured into the universe itself. This agitation and movement within and amongst individuals and collectivities was not, however, haphazard and aimless. As Proudhon viewed it, this incessant activity provided the *élan* which enabled, indeed forced, man to "make his own history" and to achieve the ultimate purposes and goals of individual and social existence.<sup>19</sup> The study of history "demonstrates that those agitations within humanity, in so far as they concern the formation, fusion, decadence, decomposition, and the recombination of states, move in a general direction" whose goal is "to create little by little harmony and liberty on this earth." The State, as a political entity, is thus an agency for the education of mankind and "the formation of humanity by independent and sovereign States appears to be a law of civilization and a law of history," and war "the act by which the political agglomerations, called States are constituted. . . ."<sup>20</sup>

Proudhon contended that it has been within the political context of the State—itself a creation of war, and under the continuous and unrelenting pressures and the imperious demands and exigencies of war and preparation for war down through the centuries—that political, social, and economic conceptions and institutions (such as the various forms of government and notions of sovereignty and authority, and hierarchy of social classes and the allocation of prestige and status, and private property) have come into existence and have been modified.<sup>21</sup> Similarly, it has been within this same context of State and war that right (*le droit*) and justice,<sup>22</sup> which made their entry into the world "by the way of force,"<sup>23</sup>

<sup>19</sup> For an extensive treatment of Proudhon's philosophy of history, see my article "History and Humanity," *loc. cit.*

<sup>20</sup> Proudhon, *La Guerre et la paix*, pp. 202, 217. "As the form of activity that produced States, war has its legitimacy: as the arbitrator of the differences among them, war has its competence. Its judgment, having no other end than that of demonstrating which side has the force and hence is affirmed in its prerogative, is veridical. This judgment, finally, is efficacious; consequently, it can and must be considered judicially valid. . ." (*ibid.*, p. 218). Cf. Herbert Spencer, *The Principles of Sociology* (New York, 1896), Vol. II, part I, pp. 278-79.

<sup>21</sup> Proudhon, *La Guerre et la paix*, pp. 23, 40, 41, 444, 51-56 *passim*, 75, 192-93.

<sup>22</sup> Justice, to Proudhon, is the "idée princesse," the element which assures the progress of man and society. "Justice is for us the axle of society, the very first and last reason (*la raison*) of the universe itself." "In virtue of the reason with which he is endowed, man has the faculty to sense or experience dignity as much in the person of his fellow human beings as in his own being, and of affirming this dignity at one and the same time as being inherent in the individual and in the species. Justice is the product of this faculty. Justice is the respect, spontaneously experienced and verified and reciprocally guaranteed, of human dignity, in all persons and in all circumstances. . . . Justice is human, all human, and nothing but human. . . . Justice has its base in humanity, and it

developed new modes of expression, political, civil, and economic, which have been embodied in procedures, codes, and institutions.<sup>24</sup> Finally, it has been under the aegis of the State and under the omnipresence of war that mankind has been educated and disciplined, trained in the manual arts and the sciences, learning the meaning and value of honor, valor, respect, obedience, cooperation, and self-sacrifice, and drawing inspiration for the creation of its folk-heroes and myths, its gods, and its poetry and song.<sup>25</sup>

War—it is our entire history, life, and soul. It is legislation, politics, the State, *la patrie*, the social structure, the rights of man, poetry, and theology. It is, in sum, everything.<sup>26</sup>

Although the overwhelming majority of those who have studied the allied questions of war and peace have, Proudhon conceded, looked upon war as "purely and simply an evil, not to say, *the evil*," and as "the negation of all right and all justice,"<sup>27</sup> in sharp opposition to "*ces savants jurisconsultes*" who have denigrated war—and here Proudhon cited Hugo Grotius, J.-J. Burlamaqui, Samuel Pufendorf, and Thomas Hobbes among others<sup>28</sup>—is the judgment on war made by the mass of humanity. Throughout history the masses have instinctually and spontaneously accorded to war the esteem and honor it merited for its positive contributions to the creation of society, the advance of civilization, and the education of humanity. "All mankind, Proudhon declared, "affirms the right of war," recognizes "*sa phénoménalité morale*," and "the role, positive as well as legitimate, that it has played in the constitution of humanity." This has been "the universal assent . . . the unanimous sentiment of all peoples." For this reason the multitude has always and everywhere honored the warrior, made him the hero of its epics and songs. The "instinctive reason" of the masses has recognized that "war, in one form or another, is essential to our humanity," that the right of force "is not only the most ancient right known and recognized, but the root-stock (*la souche*) and the foundations of all species of rights," and that its expression in war appears "as the pinnacle of human virtue."<sup>29</sup> In view of this it is understandable,

is progressive and indefectible in humanity." Proudhon, *De la Justice*, Vol. I, pp. 215, 324, 423, 426, 323, 329, 324, 217; also pp. 314-15, 328, 433; Vol. III, pp. 325-27, 513-16. See also *idem*, *La Guerre et la paix*, pp. 127-28. "Force is . . . one of the thousand fables of justice" (*ibid.*, p. 130).

<sup>24</sup> *Ibid.*, p. 136.

<sup>25</sup> *Ibid.*, pp. 183-96 *passim*. See also *ibid.*, p. xix.

<sup>26</sup> *Ibid.*, pp. 23, 41, 46-62 *passim*, 193.

<sup>27</sup> *Ibid.*, p. 71. See also *ibid.*, pp. 312-15.

<sup>28</sup> *Ibid.*, p. 194. See also *ibid.*, pp. 13, 75, 76-78.

<sup>29</sup> *Ibid.*, pp. 77-135 *passim*.

<sup>30</sup> *Ibid.*, pp. 24, 22, 32, 55, 49, 57, 75, 76, 77, 90-93 *passim*, 89, 125, 126, 132, 136, 195-227. See also Proudhon, *De la Justice*, Vol. III, p. 413.

Proudhon asserted, that the ancient peoples should see war as "divine" in origin<sup>30</sup> and identify their god (or gods) as a warrior. "Among the ancient Scythians," Proudhon noted, "the idea of the Divinity had hardly been conceived, at the spectacle of the powers of nature, than God took on the title and the attributes of a warrior." The tie between gods and war was likewise affirmed by the ancient Greeks, Romans, and other peoples of antiquity. In the New Testament as well, Jehovah is called a god of war. "War and religion amongst the noble races," Proudhon declared, "*se donnent la main.*" And since antiquity, the identification has persisted: "For the masses, the true Christ is Alexander the Great, Caesar, Charlemagne, and Napoléon."<sup>31</sup>

Up to this point in our exposition of Proudhon's sociology of war, we have considered only what Proudhon characterized as the 'positive' aspects of the dominant role of war in history and the rise of civilization. In brief, to Proudhon, war—"this civilizing and disciplining power of conquest"<sup>32</sup>—has been inextricably linked to the creation of society. War, "*l'antagonisme humanitaire*, has had as its goal the complete manifestation and absolute triumph of justice—in a word, civilization."<sup>33</sup> To Proudhon, as Henri Moysset, a student of Proudhon's thought, succinctly and accurately put it, war was "the first educator of primitive groups, the organizing force of societies, and the founder of States."<sup>34</sup> Although he acknowledged in this manner the creative, progressive function of war, Proudhon was well aware of what he took to be the 'negative' aspects of war and militarism; and he recognized that war was only characteristic of a *stage* in the growth of civilization, "*un phénomène passager*," that war, which in "the first age of humanity" had been "the only propelling force of civilization," had by the 19th century fulfilled its historic function as a civilizing force, and that its markedly negative aspects and inadequacies made its disappearance inevitable.<sup>35</sup>

<sup>30</sup> "Amongst all peoples, war is perceived originally as being a divine fact (*un fait divin*). I call divine everything that arises directly and instantaneously from the creative power of nature, in man, from the spontaneity of the spirit or the conscience. In other words, I call divine all that . . . does not admit of the competence of philosophy, *ni question, ni doute*. . . . The appearance of man on this earth is a divine fact. Where does man come from, indeed? How has he come? One does not know. . . . I say then that war is—at least that it has remained until the present time—for us a divine thing . . . impentetrable to our reason like a theophany" (Proudhon, *La Guerre et la paix*, p. 29).

<sup>31</sup> *Ibid.*, pp. 33, 34. See also *Correspondance de P.-J. Proudhon*, Vol. XII, letter to Clerc, March 4, 1863, p. 343.

<sup>32</sup> *Ibid.*, Vol. XII, p. 372.

<sup>33</sup> Proudhon, *La Guerre et la paix*, p. 478.

<sup>34</sup> *Ibid.*, introduction, p. lxxiii.

<sup>35</sup> *Ibid.*, pp. 434, 499; *Correspondance de P.-J. Proudhon*, Vol. XI, letter to Altemeyer, June 5, 1861, p. 109; Vol. XII, letter to Clerc, March 4, 1863, p. 341; letter to Clerc, March 16, 1863, p. 371; Proudhon, *La Fédération et l'unité en Italie* (Paris, 1959), p. 128; *idem*, *Théorie de Pimpo* (Paris, 1861), p. 114; *idem*, *Lettres au citoyen Rolland* (Paris, 1946), p. 178.

Proudhon, as has been noted, held that war, as an idea and in its essence, was one of the many forms of justice, the most ancient expression of justice in society, the driving force that lifted mankind out of the state of barbarism. Yet, at some point in the distant past, perhaps at the close of the heroic period (*la période héroïque*) and before the dawn of recorded history—Proudhon is not clear on this point—war underwent a profound alteration when an economic element blended in with its moral and juridical core.<sup>36</sup> From this point on, war was characterized by a "frightful contradiction" between "the fact and the idea of war," showing a "double face," the face of "an archangel and the face of a demon."<sup>37</sup>

What was the source and character of this economic element and what significance did it have historically for the social function of war? The answer to these questions involves a consideration of the related phenomena identified by Proudhon as poverty (*la pauvreté*) and pauperism (*la paupérisme*). In Proudhon's theory of society, men living in collectivities and societies were governed by "laws" which were immanent in the latter and which were "revealed little by little" to them "in the course of experience"<sup>38</sup> by the "collective conscience" and/or the "collective reason," intrinsic attributes of all natural groups of men, collectivities, and societies. To Proudhon, the laws that governed the structuring of the social order and its constituent elements—as well as the laws that governed the course of history and the progress of mankind on earth—were not the creation or revelation of any sort of deity or transcendental spirit, Hegelian or otherwise, but an *emanation* of social life as men experience it in the real world; the instinctive, gradual, often painful and costly creation of human beings in face-to-face, natural, functional relationships. In time these laws are embodied in political, social, and economic institutions, in the arts and in religion, and in the ideas and ideals of mankind. Hence, in Proudhon's view, man did, indeed, 'make himself,' and the laws of society (or the science of society as he often expressed it) were a continuing revelation of mankind *to itself*, a revelation that would continue as long as society, in the course of its development, disclosed new facets and new structures. This revelation, however, is purely secular in character.<sup>39</sup>

Some of these immanent laws are relevant to our present concern, pov-

<sup>36</sup> Proudhon, *La Guerre et la paix*, pp. 389, 433. See also *ibid.*, p. Ixxviii.

<sup>37</sup> *Ibid.*, pp. 432, 314, 319, 422.

<sup>38</sup> *Correspondance de P.-J. Proudhon*, Vol. XII, letter to Clerc, March 16, 1863 p. 368.

<sup>39</sup> See, in this connection, Bouglé, *La Sociologie de Proudhon*; Georges Gurvitch, *Pour le Centenaire de la mort de Pierre-Joseph Proudhon: Proudhon et Marx, une confrontation* (Paris, 1964); and my article "Proudhon: Socialist as Social Scientist," *American Journal of Economics and Sociology*, Vol. 26 (July 1967), pp. 313-28.

erty and pauperism. To begin with, humanity, Proudhon noted, has been placed, from its very appearance on earth, under "a group of organic laws from which it cannot escape without becoming corrupt and making itself miserable." The first of these laws is the "law of alimentation, or better of consumption, essential to the physiology of our being." The need of man to feed himself was "of all the requirements of our nature, the most imperious." This, to Proudhon, constituted, "in the economic sphere, our first law." The second law follows from the first: the need for sustenance forces man to action, to "industry and to work."<sup>40</sup> Work, however, is not simply an exertion that is physical or intellectual in character. In Proudhon's view, work was an "essential attribute of humanity," the one activity which more than any other "distinguishes man from the animals." It was the most creative, spiritual, and exalting of all human activities, "the essential characteristic of man," and not at all a "malediction of God" as affirmed in Genesis. Quite the contrary: work is "the highest manifestation of life, intelligence, and liberty," "the mother of philosophy and science," the fount of "education." Work is the concrete manifestation in the sphere of practical activity of the 'moral' dimension of human nature—indeed, to Proudhon, the source of morality and of positive moral law—as well as the affirmation of man's dignity and the agency by which man's spirit is elevated and his nature refined.<sup>41</sup>

The third of these basic economic laws, was what Proudhon called "the law of poverty, by which man, in working, produces only what is sufficient for him." Proudhon observed that the capacity of man to consume "is unlimited," while man's capacity to produce is not. This is inherent in the very nature of things: "to consume, devour, destroy—a negative, chaotic, infinite faculty." But to "produce, create, organize," this is a positive faculty, "of which the law is number and measure—that is to say, limitation." Hence, in Proudhon's view, mankind is destined by this law to work hard, yet to secure through its efforts only that which is required to maintain itself physically and to enrich its spirit, "*ni plus ni moins*." Man's limited ability to produce thus forces him to restrain his desire to consume, to discipline his appetites by "temperance and frugality." These are the "moral laws" that derive from the nature of work.<sup>42</sup> "Our destiny," Proudhon declared, "is not pleasure. . . . We have no other vocation than to cultivate our heart and our intelligence, and it is in order to aid us, or

<sup>40</sup> Proudhon, *La Guerre et la paix*, pp. 432, 327, 328.

<sup>41</sup> Proudhon, *De la Création de l'ordre dans l'humanité* (Paris, 1927), p. 329; *idem*, *Système des contradictions économiques*, Vol. I, pp. 200, 213; Vol. II, pp. 295–96, 361, 372–78 *passim*; *idem*, *De la Justice*, Vol. III, pp. 27, 81. See also *idem*, *Idée générale de la révolution au XIX<sup>e</sup> siècle* (Paris, 1924), p. 166.

<sup>42</sup> Proudhon, *La Guerre et la paix*, pp. 328, 329–30, 331.

as the case may be to compel us [to this task] that Providence has made for us the law of poverty." Poverty "is good, and we should consider it as the source of our joy (*allégresse*)."<sup>43</sup> Reason commands us to mould our life in harmony with the law of poverty by practicing "*la frugalité des mœurs*, moderation in pleasures and assiduity in work, and by subordinating in an absolute manner our appetites to justice;" for the aim of this law is "to raise unceasingly man above animality, to render him increasingly free, master of his senses, appetites, and passions."<sup>43</sup>

From this law of poverty, "the law of our nature and our social life," is derived the fourth of Proudhon's fundamental laws. This is the law of economic justice, of mutualism and commutative justice in economic relationships, which has for its goal the distribution among the members of a community of services and products in such a manner as "to equalize . . . without compromising the rights of anyone, living conditions and fortunes." The complete realization of this law produces "economic equilibrium" and social harmony.<sup>44</sup>

Whether Proudhon believed that man, at some time in the remote past, lived in harmony with these fundamental laws is not at all clear from a reading of his works. What is clear, however, is that since the period of recorded history, the evidence indicates that "all these laws" have been violated due to "popular ignorance, the suggestion of the senses, the illusions of the ideal, and the exaggeration of personal rights."<sup>45</sup> Accompanying and complementing these departures by mankind from the 'true' economic laws of frugality and poverty—departures promoted and rationalized by greed and avarice, the quest for pleasure and ease, selfishness and special privilege—is the repudiation of equality amongst the members of the community with the growth of "*parasitisme*, inequality of instruction," and the "false distribution" of the products of labor. The upshot of these developments is "the disruption of economic equilibrium" within the social order.<sup>46</sup>

The immanent economic laws disclosed by Proudhon were not to be negated or abandoned without penalty. "Nature, reason, and justice," he observed, "do not allow themselves to be outraged with impunity." The

<sup>43</sup> *Ibid.*, pp. 331, 332, 338, 432-33.

<sup>44</sup> *Ibid.*, pp. 433, 426. See also Proudhon, *De la Capacité politique des classes ouvrières* (Paris, 1924), pp. 124-42 *passim*, 193-95. "What, in fact, is mutualism? A form of justice . . . in virtue of which members of society, of whatever rank, fortune, or condition, corporations or individuals, families or towns, industrial workers, farmers, or public functionaries—all reciprocally promise and guarantee service for service, credit for credit, pledge for pledge, . . . value for value, information for information, good faith for good faith, truth for truth, liberty for liberty, and property for property" (*ibid.*, pp. 203-04).

<sup>45</sup> Proudhon, *La Guerre et la paix*, p. 433.

<sup>46</sup> *Ibid.*, pp. 426-33 *passim*, 326, 317.

cost to mankind of its fall from grace is terrible indeed, for nature, reason, and justice "find their penal sanction in pauperism," which, falling like a plague on society and attacking all classes, promotes corruption and class strife, adds to the imbalance between production and consumption of goods and services, thereby promoting economic and social distress and misery, "engenders tyranny in the State"—and what is central to our inquiry—"sows discord amongst nations and impels them towards war, *which it then corrupts in its essence and depraves.*"<sup>47</sup>

This, then, is the key to an understanding of "the mystery of iniquity," the explanation of the paradox of why war, so positive and eminently *justicière* in essence and idea, discloses in the course of history, Janus-like, the face of "bestiality." "War, in philosophic analysis and in the universal conscience of mankind," Proudhon noted, "is one thing; in the detail of its operations, it is something else. Here bestiality in its horror—there, a sublime conception, a divine ideal." As a consequence of the rupture of economic equilibrium in the social order pauperism makes its appearance, with all the deleterious effects just noted. Pauperism discloses itself as "endemic in all societies." To redress the evils produced by the imbalance of economic forces in society, to attenuate the pressures and strife generated by pauperism, societies have, throughout history, had recourse to war. These wars are quests for booty and loot, and thus to the immanent juridical element in war is added an economic element. These wars, "the daughters of famine," are characterized by pillage, massacre, rape, and other horrors; war becomes "a frightful caricature of the forms of justice."<sup>48</sup>

With the passing of the centuries, the economic element in war, Proudhon asserted, comes *increasingly* to dominate the juridical or political element; and as war becomes more materialistic in character its spiritual dimension contracts. This has been particularly true since the invention of gun powder which rendered the notion of the soldier as a gladiator and the clash of arms as a kind of duel of courageous peers increasingly irrelevant. Because of the economic element, war is "*fatalement infectée*," and with the increase in military hardware and the rise of the modern mass army "all the moral sentiments amongst the combatants" have been "paralyzed."<sup>49</sup>

Despite this intermingling of juridical-political elements and economic

<sup>47</sup> *Ibid.*, pp. 433, 459, 317–432 *passim*. See also Jeanne Duprat, "Le Paupérisme, facteur de bellicisme d'après Proudhon," *Annales de l'Institut international de sociologie*, Vol. 16; *Sociologie de la guerre et de la paix* (Paris, 1932).

<sup>48</sup> Proudhon, *La Guerre et la paix*, pp. 314, 319, 363, 381, 426, 432.

<sup>49</sup> *Ibid.*, pp. 241, 254–56, 278, 313, 326, 362–78 *passim*, 440, 459, 462.

elements in war and the gradual retreat of the former in the face of the ascendancy of the latter element in the course of history, Proudhon insisted that war, its horrors and crimes notwithstanding, managed to carry out its providential task: war created the political State and endowed it with its basic institutions and ideologies. By the dawn of the 19th century, however, war had, in Proudhon's view, completed its tasks; it had "*rempli sa mission*," exhausted its usefulness, lost any legitimate, creative role in the life of humanity, and was destined to disappear. War had been indispensable in the long "political phase" of the growth of civilization, the phase characterized by the formation of political institutions. This phase had come to a close with the French Revolution. This Revolution, to Proudhon the decisive event in modern history, inaugurated a new phase in the ascending march of humanity towards its goal, "*l'âge social*,"<sup>50</sup> in which economic and social matters now took precedence over political and in which the imperious task was the realization of economic and social justice. Writing in 1861 Proudhon declared: "The great question, *la grosse affaire*, the one which surpasses all others . . . is the economic question . . . politics, today, is political economy," and "in economic matters the jurisdiction of war is incompetent."

In the past war was concerned only with the grouping and balancing of political forces. Today, the question is one of organizing economic forces. In what way could war with its tribunal of blood provide a solution to this new problem?<sup>51</sup>

The central task of the 19th century, in Proudhon's view, was to achieve social peace and harmony within and among societies and States by bringing to an end the pauperism which had disfigured war and agonized humanity through the ages. This was to be realized by removing the basic cause for pauperism, namely, the rupture of economic equilibrium in the social order. At this point Proudhon's sociology of war merges into his own anarcho-socialist theory, and it would take us far beyond the scope of this paper to present his solution to the problem of pauperism in any detail. It will suffice to note that what he believed was called for, if peace and justice were to reign in modern society, was the re-structuring of society in the light of the 'true' principles or laws of economics outlined above.<sup>52</sup>

<sup>50</sup> Proudhon's theory of 'phases' or 'stages' in the development of civilization bears the imprint of Auguste Comte. See, in this connection, Georges Guy-Grand's introduction to Proudhon, *De la Justice*, Vol. I, pp. 66-67; my article, "History and Humanity," *loc. cit.*

<sup>51</sup> Proudhon, *La Guerre et la paix*, pp. 466, 319, 400, 434, 438, 458, 462, 369, 480, 481, 486, 500, 502, 508. See also Proudhon *Idée générale*, pp. 125-28, 151, 155-57; *idem*, *Programme révolutionnaire* (Paris, 1938), p. 333; *idem*, *Contradictions politiques* (Paris, 1952), p. 161.

<sup>52</sup> Proudhon, *La Guerre et la paix*, pp. 384-85, 389, 463, 467, 483-98 *passim*. See also Proudhon, *De la Liberté politique*, pp. 74-84 *passim*.

Although war as it had existed in history had no role to play in the creation of this just society, Proudhon insisted that "a transformation of the antagonism" which was embodied in the right of force or strength and made manifest in the course of civilization in the form of war did, indeed, have a continuing function, an indispensable function, to perform in the new phase of civilization. This antagonism was, as noted earlier, immanent in man and society. The struggle and clash of contending interests, ideas, and ideals would continue to be characteristic of human history in the future as in the past. War, however, was only *one* of the forms or expressions of this fundamental antagonism. In the new order that was to come, Proudhon, following Henri de Saint-Simon among others,<sup>53</sup> contended that political institutions would be absorbed into the economic institutions. In the new mutualist anarcho-socialist order—an order characterized by the full realization of justice and liberty—conflict and struggle, indispensable to the complete realization of an ever-richer and more humane social order, would dominate the *economic* plane rather than the battlefield. "The shop (*atelier*) is the new field of battle"<sup>54</sup>—and the new 'warrior' is the worker: "the warrior has been the forerunner of the worker."<sup>55</sup>

Thus, the transformation of the form that antagonism takes is the outcome of its own definition, movement, law, and ultimate goal. Antagonism, in effect, does not have as its goal destruction pure and simple. . . . Its goal is the production of an order that is always superior in character—an order that aims at perfection. From this standpoint, it is necessary to acknowledge that work offers antagonism a field of operation far more extensive and fecund than war.<sup>56</sup>

In Proudhon's sociology of war, therefore, after war has fulfilled its active, providential role in history—after it has made its indispensable contribution to the development of society and to the growth of civilization and ceases to be a concrete phenomenon in the social life of mankind—war, as a prototype and memory, continues to hover like a guardian spirit and inspiration over a struggling humanity.

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<sup>53</sup> See Georges Gurvitch, *Les Fondateurs Français de la sociologie contemporaine, Saint-Simon et P.-J. Proudhon: Saint-Simon—Sociologue* (Paris, 1955), especially pp. 60–62; Bouglé *La Sociologie de Proudhon*, pp. 184–85; Jeanne Duprat, *Proudhon, sociologue et moraliste* (Paris, 1929), pp. 246–47.

<sup>54</sup> *Carnets de P.-J. Proudhon*, Vol. 1, p. 348.

<sup>55</sup> *Correspondance de P.-J. Proudhon*, Vol. XII, letter to Clerc, March 16, 1863, p. 370. See also Edouard Berth, "Le Centenaire de Proudhon," *Le Mouvement socialiste* (January 15, 1909), pp. 52–53; Célestin Bouglé, "Le Pacifisme de Proudhon," *La Grande Revue*, Vol. 15 (June 1911), pp. 526–27.

<sup>56</sup> Proudhon, *La Guerre et la paix*, p. 483.

## The Role of Foreign Trade in Financing Soviet Modernization\*

By JOSEPH WATSTEIN

1968 MARKED THE 40TH ANNIVERSARY of the inauguration of the First Five-Year Plan in the Soviet Union. In the 1930s planning appeared particularly a product of Russian experience and was anathematized by conservatives everywhere. But within the span of four decades economic planning gained a gradual acceptance, breaching such citadels of economic orthodoxy as Spain and Nationalist China. And its rags-to-riches allure appeals particularly to the developing nations which know little about the real cost of the first Five-Year Plan to the Russian people.

This study will deal with a largely neglected field—the costs of the economic transformation imposed upon Russia by a coercive State. Equally neglected is another area of our study—the pivotal role of Soviet foreign trade in securing the wherewithal for effecting this economic transformation. Foreign trade was truly Russia's engine of growth.

Let us hasten to add that it was not just the Russians who had developed and effectuated this concept of foreign trade. Foreign commerce *had been* an engine of growth in the past, particularly during the 19th century, for a number of developing countries in Latin America, Asia and Africa. In fact, H. Myint deals at length with the role played by foreign trade in the economic development of "backward" countries.<sup>1</sup> But no country had ever done it on such a cosmic scale and against such massive odds. For the beginning of the First Five-Year Plan coincided with the advent of the world depression, and Russian planners encountered extremely unfavorable terms of trade. The prices of Russia's primary staples had tumbled on the world markets while the prices of machinery and industrial equipment, so vital to Russia's supreme goal of industrialization, remained virtually unchanged. James A. Farrell summed up the situation succinctly: "The effects upon European countries of the prolonged depression make it in-

\* The following study was undertaken at the suggestion of Dr. Ernest Rubin, director of the Sino-Soviet Division, U. S. Department of Commerce. The opinions expressed are those of the author and not necessarily those of any public or private agency with which he is associated.

<sup>1</sup> Cf. his "The Classical Theory of International Trade and the Underdeveloped Countries," *Economic Journal* (June 1958), and "The Gains from International Trade and the Backward Countries," *Review of Economic Studies*, Vol. 32, pp. 1954-55.

creasingly difficult for Soviet Russia to supply its pressing needs by purchases based on long-term credits."<sup>2</sup>

A firm resolve to industrialize the Union of Soviet Socialist Republics rapidly was apparent in Soviet policies from the outset, and foreign trade was assigned a truly crucial role in this herculean task. Standing guard over commercial traffic and exercising the required leverage was the state monopoly of foreign trade. Established very early in the Soviet era (April 2, 1918), the monopoly had from the outset been one of the "commanding heights" of the Socialist sector of the Soviet economy. Even in the era of the New Economic Policy (NEP) when the private sector was permitted to expand all the way to the field of light manufacturing, the monopoly of foreign trade remained inviolate. A well-authenticated story is told of an encounter in the early NEP years between Lenin and the brilliant Leonid Krasin. The latter, a highly successful industrial executive in the pre-revolutionary days and an early convert to the cause of Bolshevism, was made the top Soviet trade negotiator. He was about to close a most attractive trade deal in the West but was given to understand that the transaction could not be consummated unless the Soviet State monopoly of foreign trade was abrogated, at least temporarily. Krasin transmitted the message to Lenin and suggested cautiously that there might be some merit to the proposal. Lenin asked him coolly whether he had lost his mind. The deal fell through, and thereafter no one surpassed Krasin in affirming the sanctity of the foreign trade monopoly and its crucial benefits to Soviet economic development.

And Krasin was echoed by nearly all Soviet leaders and economists who regarded the monopoly as the alpha and omega of Soviet economic policy. "Giving up the monopoly of foreign trade would have meant suicide for the proletariat of the U.S.S.R.," said one of the top Soviet economists. And these top people were nearly unanimous in stressing the inadequacy of customs barriers.

Mere customs barriers, no matter how prohibitive, cannot save the Soviet economy from the economic penetration of world capital, and without the monopoly of foreign trade the Soviet State could not even begin the building of its economy on Socialist principles . . . under conditions of early Soviet economic weakness any rich industrial country could break through the Soviet customs barriers.<sup>3</sup>

In fact, customs duties in the Soviet Union hold a strictly subsidiary

<sup>2</sup> James A. Farrell, *Russo-American Trade Relations*, (New York: National Foreign Trade Council, 1934).

<sup>3</sup> D. I. Kutuzov, ed., *Vnyeshnaya Torgovlya S.S.S.R. za 10 lyet* (The Foreign Trade of the U.S.S.R. for ten years), Moscow: Narkomtorg SSSR i RSFSR (People's Commissariat of Trade of the U.S.S.R. and Russian Socialist Federated Soviet Republic, 1938).

role, namely, that of discouraging Soviet economic organs from purchasing certain commodities abroad instead of managing their production inside the country.

The undoubted advantages of the monopoly of foreign trade to the Soviet economy in its formative years were conceded and underscored by a scholarly Western observer, Alexander Baykov:

Monopoly of foreign trade can protect the home market completely from foreign competition, eliminating any need for tariff walls. The volume of imports is directly controlled by the issuing of import licenses. . . . Profits gained on exports can offset losses incurred on imports, or vice versa, so that each individual export and import operation can be considered not on its own merits but as profitable or otherwise to the national economy as a whole.<sup>4</sup>

Baykov also stressed the lower overhead charges and the stronger bargaining position effected by the foreign trade monopoly.

## I

WITH THE FLANKS of the Soviet economy thus effectively secured by its trade monopoly, the Soviet planners proceeded next to the creation of a viable foreign trade apparatus.

The organizational throes of Soviet foreign trade corporations which were suffering from a lack of experience and trained personnel, were reflected in alternate consolidations and dissolutions of various agencies with their tongue-twisting names. Their tedious enumeration is outside the scope of this study but the interested reader is referred for detailed analysis to Baykov's classical work. The period of trial and error ended with the advent of the First Five-Year Plan and the onset of world depression. What finally emerged late in 1930 was the Narkomvnyeshtorg (the People's Commissariat of Foreign Trade). This general staff of Soviet foreign trade mothered a whole cluster of exporting and importing societies and "torgpredstva" (trade delegations abroad). And, of course, the Customs Administration was an integral part of Narkomvnyeshtorg.

The administration of foreign trade was thus firmly vested in the Narkomvnyeshtorg. Domestic industrial enterprises, People's Commissariats and cooperative societies were expressly barred from any participation in foreign trade. The only exceptions allowed to regular commercial agencies were those granted to Intorgkino (Foreign Film Trading Corporation), Soyuzphoto (Union Photo Corporation), and similar organizations. Otherwise, the entire business of export and import was handled,

<sup>4</sup> Alexander Baykov, *Soviet Foreign Trade*, (Princeton, N. J.: Princeton University Press, 1946).

as a rule, by special, strictly self-supporting State exporting and importing societies. These were organized functionally, specializing in specific groups of commodities, and were granted a monopoly in the field.

This apparatus of foreign trade underwent no major change in the years 1930-40, with the exception of a modification decreed by a government regulation of July 7, 1935, specifying that henceforth most export and import business should be negotiated not abroad but within the U.S.S.R.

## II

"SOVIET FOREIGN TRADE is an integral part of the national economic plan and serves to aid the Soviet Union in attaining the overall plan's goals. Exporting is considered necessary only to obtain foreign currency required for import payments rather than something beneficial in and of itself . . . The planners generally strive toward the Soviet goal of achieving economic independence from foreign markets rather than integrating their economy with those of foreign countries." Thus succinctly does "U.S.-Soviet Trade—Facts for the Businessman's Appraisal"<sup>5</sup> formulate the basic Soviet approach to foreign trade.

The Soviet planners saw very early that foreign trade was their main vehicle for securing the rebuilding of their ravaged economy and for launching the stupendous program of industrializing Russia. But they did not let the rest of the world in on their secret until the first decade of this drive for industrialization was over, and the program had scored some undeniable successes. A leading Soviet foreign trade theoretician—D. D. Mishustin—spelled out the role of Soviet foreign trade in that crucial decade:

Our exports serve to secure the valuta (foreign exchange) and by means of this valuta we have imported the equipment and the means of production indispensable to heavy industry; thus foreign trade had served and continues to serve as a mighty lever for the accelerated fulfillment of our industrial plan.<sup>6</sup>

And further on in his text, Mishustin goes into some interesting detail:

Foreign trade had played a particularly pivotal role in the period of the First Five-Year Plan. The rebuilding of our industry had scored some successes, but in the areas of metals and machinery our industry still limped badly. . . . The imperatives of faster tempos of industrialization, of a creation of high-powered metallurgical industry and of machinebuilding

<sup>5</sup> "U.S.-Soviet Trade—Facts for the Businessman's Appraisal," Trade Research Associates, Cleveland, Ohio, 1960.

<sup>6</sup> D. D. Mishustin, *Sotsialisticheskaya Monopoliya Vnyeshney Torgovli SSSR* (The Socialist Monopoly of Foreign Trade in the U.S.S.R.), (Moscow: Myezhdunarodnaya Kniga (International Book Publishing Company), 1938).

industries in the shortest possible time demanded an expansion of our trade relations with capitalist countries in order to utilize their advanced technology for the quickest realization of our goals. This posed the problem of not squandering the precious valuta on items of secondary importance but on importing *le dernier cri* of capitalist technology—equipment of the very latest design and construction in order to free the country from the need of importing this machinery and equipment once the goal had been reached.

Thus, the paramount importance of foreign trade to the campaign for transforming Russia could not be plainer. And the basic thrust to self-containment, to autarky emerges with equal force.

### III

RUSSIA'S PRINCIPAL TRADE PARTNERS during this period of industrial transformation were, in the order named, Germany, Great Britain, and the United States. "Russia needed little that Japan could supply."

Imports from Germany occupied the first place in total imports of the Soviet Union and in the entire prewar period, they were considerably greater than imports from the United States. To some extent, this consistent primacy of German imports was due to Russia's traditional dependence on trade with Germany. But comparatively generous German credits had probably played the major role—in order to attract Soviet import orders for the German market, even during the Hitler era, the Soviet Union was provided with greater credit facilities by Germany than by the United States or Great Britain.

The Soviet Union had managed to build a very favorable balance of trade with Great Britain. In fact, Britain resented being cast in the role of an "International Fall Guy." In its new trade agreement with Russia, the United Kingdom aimed at gradual correction of its trade balance which now heavily favored Russia, until the U.S.S.R. bought as much in Great Britain as it sold there.

Russia's deep predilection for America's machinery and equipment, which were particularly suited to Russian conditions, made it turn eagerly to the American market. But it found the climate there not very propitious for Soviet exports. The main drawback was the systematic adverse trade balance and the difficulty of securing long-term credits in the United States.

The Soviet drive for autarky had not escaped the notice of James A. Farrell, the author of *Russo-American Trade Relations*.<sup>7</sup> His analysis of the difficulties of trade between the United States and the U.S.S.R. is

<sup>7</sup> Farrell, *op. cit.*

worth noting because it was typical of some of the attitudes prevailing in the United States in the 1930's.

Farrell warned that Soviet foreign trade might be a one-shot affair carefully tailored to secure currency for the rapid industrialization of Russia. Once this grand objective had been reached the Soviet-American trade would trail off to a mere trickle. He also observed that "Russia is a market for producer goods." The foreign trade of the United States has been developed largely by the sale abroad of consumer goods and trade with the Soviets "would ultimately tend to bring about the conditions complained of in England and Italy, by seriously dislocating our trade with other exporting countries."

Farrell presented an interesting case study of manganese—one of Russia's prime exports. Our normal consumption of manganese was about 500,000 tons annually at the time. From domestic sources we obtained 50,000 tons annually. Without the Russian manganese, we could still supply all our domestic requirements from Brazil, Cuba, and the West Coast of Africa. Importation of this staple from Soviet Russia would disrupt our trade relations with valued and established customers, and after the spurt of the Soviet trade was over, we would face resentful customers.

Farrell's caveats were echoed in some other quarters.

... Reports from Washington indicate that our Government officials find great difficulty in discovering in our import needs any present hope of greatly increasing our imports from Russia.<sup>8</sup>

Under the circumstances, it is surprising that Russia was able to finance exports of machinery and vehicles from the United States (which made up the bulk of our exports to the Soviet Union) of \$95 million in 1930 and \$103 million in 1931. Russia was doggedly going for broke in its trade with the United States, resigning itself to a permanently unfavorable trade balance while trying to readjust the imbalance through the channels of multilateral trade and relentlessly lowering living standards at home. A Czarist Minister of Finance—Vyshnegradsky—once observed: "We shall starve if need be but we'll keep exporting grain." Soviet leaders, too, in order to gain the precious valuta were exporting some items that were badly needed at home.

Actual starvation of major proportions did occur in the Ukraine in 1932-34, although reports about it were suppressed at the time and were not authenticated by the world press until years later. Information on the famine is fragmentary and not fully documented (the Soviets saw to that!). But Dana G. Dalrymple of the U.S. Department of Agriculture did a

<sup>8</sup> *Ibid.*



trade in the territory of the U.S.S.R. and b) mixed companies (*i.e.* companies whose capital was partly owned by Eastern merchants and partly by the Soviet State). The Moscow, Baku and Odessa commodity exchanges acted as intermediaries between the Eastern traders and the Soviet economic organs. Substantial business was also transacted at the annual fairs of Baku and Nizhni-Novgorod (Gorky). A special All-Union Corporation, the Vostogostorg (Eastern Trading Corporation) was created and granted the monopoly of Soviet trade with Eastern countries. In 1937 a special monopolistic entity—the Soviranturtorg—was created to trade with Iran and Turkey, hitherto handled on the same basis as the European countries.

These special features in the organization of trade with the Eastern countries derived from the special character of the Soviet trade with these areas. They supplied agricultural and livestock products needed by the U.S.S.R. and they made up the principal market for finished industrial products exported by the Soviet Union. These products were exported by the Soviets not because of the existence of an exportable surplus but merely to pay for needed imports. The Eastern countries were also the area where the Soviets could, although they were not anxious to stress the point, dispose of goods not likely to sell elsewhere. But the Eastern area was no big valuta-earner for the Soviets—the exports and imports were pretty nearly balanced.

## V

IT SOON BECAME APPARENT that the success or failure of Russia's epic developmental efforts depended above all upon domestic stability and international harmony among Russia's principal customers. But the international scene was anything but idyllic at the time. The three "have-not" nations—Germany, Italy and Japan—were pressing their claims during the 1930s for "living space" and a revision of frontiers and by one of the singular turnabouts of history, Russia became a champion of international tranquility. *The London Times*, in its issues of July 5, 6 and 7, 1937, took due note of this "transformation from international rebel into international conservative" in a series of articles dealing with the incipient Third Five-Year Plan. The "Thunderer" chided the Soviets for burgeoning Holy Alliance tendencies, with Maxim Litvonov turning into a latter-day Metternich:

"It soon became clear that the worst thing which could happen to the Five-Year Plan would be a political or economic upheaval affecting world policies or the purchasing power of Russia's principal customers. World Revolution far from being the primary objective of Soviet policy, would

industries in the shortest possible time demanded an expansion of our trade relations with capitalist countries in order to utilize their advanced technology for the quickest realization of our goals. This posed the problem of not squandering the precious valuta on items of secondary importance but on importing *le dernier cri* of capitalist technology—equipment of the very latest design and construction in order to free the country *from the need of importing this machinery and equipment once the goal had been reached.*

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worth noting because it was typical of some of the attitudes prevailing in the United States in the 1930's.

Farrell warned that Soviet foreign trade might be a one-shot affair carefully tailored to secure currency for the rapid industrialization of Russia. Once this grand objective had been reached the Soviet-American trade would trail off to a mere trickle. He also observed that "Russia is a market for producer goods." The foreign trade of the United States has been developed largely by the sale abroad of consumer goods and trade with the Soviets "would ultimately tend to bring about the conditions complained of in England and Italy, by seriously dislocating our trade with other exporting countries."

Farrell presented an interesting case study of manganese—one of Russia's prime exports. Our normal consumption of manganese was about 500,000 tons annually at the time. From domestic sources we obtained 50,000 tons annually. Without the Russian manganese, we could still supply all our domestic requirements from Brazil, Cuba, and the West Coast of Africa. Importation of this staple from Soviet Russia would disrupt our trade relations with valued and established customers, and after the spurt of the Soviet trade was over, we would face resentful customers.

Farrell's caveats were echoed in some other quarters.

... Reports from Washington indicate that our Government officials find great difficulty in discovering in our import needs any present hope of greatly increasing our imports from Russia.<sup>8</sup>

Under the circumstances, it is surprising that Russia was able to finance exports of machinery and vehicles from the United States (which made up the bulk of our exports to the Soviet Union) of \$95 million in 1930 and \$103 million in 1931. Russia was doggedly going for broke in its trade with the United States, resigning itself to a permanently unfavorable trade balance while trying to readjust the imbalance through the channels of multilateral trade and relentlessly lowering living standards at home. A Czarist Minister of Finance—Vyshnegradsky—once observed: "We shall starve if need be but we'll keep exporting grain." Soviet leaders, too, in order to gain the precious valuta were exporting some items that were badly needed at home.

Actual starvation of major proportions did occur in the Ukraine in 1932-34, although reports about it were suppressed at the time and were not authenticated by the world press until years later. Information on the famine is fragmentary and not fully documented (the Soviets saw to that!). But Dana G. Dalrymple of the U.S. Department of Agriculture did a

<sup>8</sup> *Ibid.*

painstaking job of piecing together nearly the complete story from a multitude of sources.<sup>9</sup>

The trouble stemmed from the fierce resistance on the part of the Ukrainian peasants to the collectivization drive of the Government. For Stalin held that wheat exports, so necessary for securing valuta, would be increased sharply with the peasants fully collectivized. "The famine, it soon became apparent, provided a method for driving the last of the die-hards into the State or collective farms, or out of existence."

Estimates of the number of deaths from the famine and the famine-induced typhus, ranged from 1,000,000+ to 10,000,000 and averaged out at 5,500,000.

Table 1  
EVOLUTION OF SOVIET FOREIGN TRADE  
By Type of Machinery, Vehicles, and Selected Other Products  
(in thousand rubles)

<i>Industrial Products</i>	<i>Imports</i>			<i>Exports</i>		
	1909/13	1929	1934	1935	1936	1937
Agricultural machines	177,390	254,359	1,743	2,120	2,907	3,753
Motor vehicles and parts	42,556	54,268	6,066	8,230	11,908	27,003
Tractors	—	120,953	105	153	328	1,051
Textile machinery	9,697	45,956	3,517	8,361	857	4,347
Sewing machines	37,730	4,020	1,576	1,359	1,213	1,901
Electric lamps	13,534	556	915	806	558	439
Soap	5,501	—	2,395	2,492	2,622	2,836
Pig iron	3,841	665	5,050	16,017	24,403	16,260

SOURCE: D. D. Mishustin, *Vnyeshnaya Torgovlya Industrializatsia SSSR* (Foreign Trade and the Industrialization of the U.S.S.R.), Moscow, 1938.

Mr. Dalrymple quotes the manager of a collective farm who sought to rationalize the food exports by stating: "You see, starvation is one thing and foreign exchange is another" . . .

Further comment would seem superfluous.

#### IV

OUR SURVEY of Soviet foreign trade would not be complete without a recital of the colorful chapter of Soviet deals with Eastern countries. This was the one area in which Soviet industry had no competition to fear, and the foreign trade monopoly could accordingly be liberalized. During the NEP period, trade was carried out by a) Eastern merchants allowed to

<sup>9</sup> Dana G. Dalrymple, "The Soviet Famine of 1932-34," *Soviet Studies*, Oxford, Eng., Vol. 15, No. 3 (January 1964), pp. 271, 272, 275.

trade in the territory of the U.S.S.R. and b) mixed companies (*i.e.* companies whose capital was partly owned by Eastern merchants and partly by the Soviet State). The Moscow, Baku and Odessa commodity exchanges acted as intermediaries between the Eastern traders and the Soviet economic organs. Substantial business was also transacted at the annual fairs of Baku and Nizhni-Novgorod (Gorky). A special All-Union Corporation, the Vostogostorg (Eastern Trading Corporation) was created and granted the monopoly of Soviet trade with Eastern countries. In 1937 a special monopolistic entity—the Soviranturtorg—was created to trade with Iran and Turkey, hitherto handled on the same basis as the European countries.

These special features in the organization of trade with the Eastern countries derived from the special character of the Soviet trade with these areas. They supplied agricultural and livestock products needed by the U.S.S.R. and they made up the principal market for finished industrial products exported by the Soviet Union. These products were exported by the Soviets not because of the existence of an exportable surplus but merely to pay for needed imports. The Eastern countries were also the area where the Soviets could, although they were not anxious to stress the point, dispose of goods not likely to sell elsewhere. But the Eastern area was no big valuta-earner for the Soviets—the exports and imports were pretty nearly balanced.

## V

IT SOON BECAME APPARENT that the success or failure of Russia's epic developmental efforts depended above all upon domestic stability and international harmony among Russia's principal customers. But the international scene was anything but idyllic at the time. The three "have-not" nations—Germany, Italy and Japan—were pressing their claims during the 1930s for "living space" and a revision of frontiers and by one of the singular turnabouts of history, Russia became a champion of international tranquility. *The London Times*, in its issues of July 5, 6 and 7, 1937, took due note of this "transformation from international rebel into international conservative" in a series of articles dealing with the incipient Third Five-Year Plan. The "Thunderer" chided the Soviets for burgeoning Holy Alliance tendencies, with Maxim Litvonov turning into a latter-day Metternich:

"It soon became clear that the worst thing which could happen to the Five-Year Plan would be a political or economic upheaval affecting world policies or the purchasing power of Russia's principal customers. World Revolution far from being the primary objective of Soviet policy, would

be a disaster of the first magnitude. The world economic crisis was a period of great anxiety for the directors of the Soviet economy.

Now on the eve of the Third Five-Year Plan, Soviet economists are trembling lest their careful calculations should once more be thrown out of gear by a change in the gold policy of the leading capitalist countries, the Soviet Union having become the second largest producer of gold. Since 1928 the international relations of Soviet Russia have been precisely similar to those of any ordinary capitalist State."

And "menaced by the growing turbulence of the 'dissatisfied powers,' Russia joined the 'static' group of respectable, satisfied powers . . . no member of the Council of the League of Nations has been more insistent on the importance of keeping things as they are . . . than M. Litvinov. It is the last and most remarkable metamorphosis of the most dramatic revolution of modern times."

Table 2

BASIC COMMODITY STRUCTURE OF SOVIET EXPORTS

Year	Agricultural Products	Industrial Products
	(percentages)	
1935	26.7	73.3
1936	20.3	79.7
1937	31.7	68.3
1938	36.4	63.6

VI

DESPITE THE DIRE PROGNoses of trade and economic experts in the West (and these were echoed, privately, by some Soviet economists), the Soviet program of industrialization-through-trade had attained most of its objectives. The great turning point occurred in 1935. The world could only guess at the costs, economic and human.

The streamlined network of Soviet trade organizations centering around Narkomvnyeshtorg had proved its worth.

The system succeeded throughout the 1930-34 period in maintaining the volume of Soviet exports at a level somewhat above that reached in 1929, although the world crisis in these years had brought about a marked decline in world trade. The marketing of Soviet exports met with many difficulties in the crisis with the result that goods had to be sold at low prices. Nevertheless, it was possible in this period to import materials and equipment on a large scale for the planned industrialization of the country. By the end of the period, the necessity for an extreme expansion of exports to pay for the urgently needed imports could be regarded as over. Thus, does Baykov neatly encapsulate the stormy history of those seminal years.

The basic *modus operandi* of the Soviet trade directors involved using the generally favorable trade balance derived from its large trade with industrial Europe for providing the exchange needed for growing imports from the overseas countries—mainly the United States.

Ingenuity of Soviet trading organizations in garnering the indispensable valuta was only matched by their callousness. As an example: when the volume of exports had to be reduced, the items chiefly affected by the contraction were as a rule the less valuable products, and to a lesser extent the more valuable items. Thus, the export of butter, sugar, bacon and other relatively valuable agricultural products was curtailed to a lesser extent than the export of grain. The effect of these maneuvers on the Soviet consumer can be easily imagined.

For all the heavy discounting of the tendentious and boastful Soviet statistics, an unmistakable aura of Soviet success began to emerge towards the end of 1933. *Business Week* gave a sober account of Soviet progress:

The Russia which has been negotiating through Maxim Litvinov is not the undeveloped Russia which the average American thinks it is. The Soviets, last year, for instance, produced more agricultural machinery than any other country in the world. They were surpassed only by the United States in the production of oil, general machinery, pig iron and cotton. Only the United States, Great Britain, and Germany produced more coal last year than the Soviets. They approached France in 1932 in the production of electricity, pulled themselves into sixth place among world producers.<sup>10</sup>

And about the same time some British experts noted some portentous changes in the structure of the Soviet manufacturing sector. "In Great Britain it is the opinion that the saturation point had been reached for the present in the imports of heavy machinery and industrial equipment."<sup>11</sup>

As we noted before, a definite breakthrough seemed to be achieved by the Soviets around 1935.

There was a mood of almost surprised satisfaction in the celebration of the New Year in January 1936. It was clear, at least in Moscow, that the Plan had taken effect. Now that the heavy plant was there, consumers' goods were being produced at a greater rate; the Government stores showed an abundance of the more necessary and useful goods; motor traffic filled the streets.<sup>12</sup>

And Louis Fisher recited a litany of Russian economic achievements:

<sup>10</sup> *Business Week*, Nov. 18, 1933.

<sup>11</sup> Farrell, *op. cit.*

<sup>12</sup> Bernard Pares, *A History of Russia*, United States Armed Forces Institute (Washington, D. C.: Alfred A. Knopf, 1944).

The upbuilding of the U.S.S.R. which has proceeded at an unprecedented pace since 1929, is only now acquiring a real momentum. In the Kharkov Tractor Plant and other factories, I saw complicated Soviet lathes which have replaced imported machines. The U.S.S.R. is not only making machines; on a considerable scale it is making machines which make machines, and its technical dependence on the West is likely to taper off to near zero in less than two years. From being the most backward, the Donetz coal basin is today the most completely mechanized mining district in Europe, with the exception of some Belgium fields.<sup>13</sup>

Russia even ventured in foreign aid to less developed countries. *Business Week* reported on September 28, 1935: "With industrialization at home well in hand—though far from complete—Russia's beginning to help neighboring countries build up their industries. New projects in 2 countries emphasize this development." It went on to recount the technical aid and credits extended by the U.S.S.R. to Turkey and Iran to help those countries build up textile industries.

The scholarly Harry Elmer Barnes summed up succinctly Russia's industrial transformation:

Not only did the First Five Year Plan greatly increase the total industrial output of Russia—in 1932 it stood at 334 per cent of prewar output and 219 per cent of the 1928 output—but it also transformed Russia from a preponderantly agricultural to a dominantly industrial country. In 1927–28 industrial output amounted to only 48 per cent of the total national output, whereas in 1934 it constituted 72 per cent.<sup>14</sup>

## VII

How WAS RUSSIA able to surmount its formidable handicaps and effect an industrial transformation within a span of eight to ten years?

Much can be attributed to the Russian talent for horsetrading. George F. Kennan said somewhere that while Russia may have been deficient in prerevolutionary days in building great manufacturing industries and developing its own Fords and Krupps, it was eminently successful throughout its history in maintaining a highly viable class of merchants. "Kupechestvo" had been for centuries a deeply-rooted and widely-respected estate of Russian society. Perhaps it was their oriental heritage that set the Russian tradition for haggling and shrewd negotiating.

Berlin officials declare they never dealt with shrewder negotiators than the little group in Moscow which was headed by the keen-eyed Armenian-

<sup>13</sup> Fisher, "The Russian Giant in 1935," *The Nation*, Oct. 23, 1935.

<sup>14</sup> Harry Elmer Barnes, *An Economic History of the Western World*, (New York: Harcourt, Brace and Company, 1937).

Russian Foreign Trade Commissar Mikoyan, nor have they ever had handed to them international contracts drawn up more exactly.<sup>15</sup>

Hard negotiating was the rule in all Soviet trade contacts with the outside world, and the Soviet traders manipulated the intricate web of their foreign trade connections with a consummate skill.

But these surpassing negotiating skills could only play a relatively minor role, and did not reach the heart of the problem. For, Russia at the time was weak and poor, and the hardnosed foreign traders knew it, and did not spare its weakness and poverty.

So, *faute de mieux*, the problem of forced industrialization could only be solved by imposing a Spartan austerity upon the peoples of the Soviet Union.

The sacrifices the Russian people made for the initial progress were staggering. Unable to attract capital from abroad, the Soviet Government employed all means to utilize whatever meager resources it was able to find. Loans were floated to which at first towns, and only later rural communities had to subscribe. The bleeding of every ruble of capital brought the nation to a low standard of living, a monotonous, austere daily grind from which the Second Five-Year Plan could still hardly relieve the masses.<sup>16</sup>

Daily living in Russia during the years of the First Five-Year Plan must have seemed to Westerners visiting the country at the time as little less than miserable, and, while there was some enthusiasm on the part of the younger generation, exhilarated by the vision of the transformation of their country, the rest of the population bore its sacrifices with grim, stoic fortitude. Many observers, both Russian and foreign, have felt that the awful austerity of those years changed the whole tone and style of Russian life for many years. Drabness and an utter lack of grace and elegance characterized Russian society from top to bottom. Such was part of the staggering price paid by the Russian people for their nearly miraculous industrial transformation.

### VIII

THE VISION of an imminent flood of consumer goods pouring from the new Soviet plants, fancied by some commentators, proved to be hollow, for the lengthening shadow of the coming Armageddon was falling across the Russian land. The Soviets were girding themselves for the imminent battle and again the Soviet consumer had to be sacrificed.

<sup>15</sup> *Business Week*, June 1, 1940.

<sup>16</sup> Anatole G. Mazour, *Soviet Economic Development—Operation Outstrip: 1921-68*, (Princeton, N. J.: D. Van Nostrand Company, Inc., 1968).

The Second Five-Year Plan was altered in the course of its fulfillment, largely due to the increased threat of war and the continued rise in armaments. The original plan called for a 150 per cent increase in light industry output between 1933 and 1938. By 1936 it was reduced to 100 per cent.<sup>17</sup>

The *Literary Digest* (now defunct) was among the first to call the country's attention to the underlying realities. On August 8, 1936, it commented on Russia's new posture:

Russia was growing increasingly independent of the capitalist world because of the development of its industries; the Soviet also desired to limit foreign purchases so that it will save foreign exchange and build up its gold reserves (now \$1 billion) in preparation for its showdown with Germany and Japan.

Russia was rearming furiously. Priorities were reordered ruthlessly again, with consumer goods pushed to the very bottom of the list. Highly significant was the increase in the stockpiling of strategic materials such as rubber.

The Soviet Union faced a most delicate situation, tradewise, at the outbreak of war in Europe in 1939. She was now reaping the whirlwind of her political and military misdeeds. France and England, bitter and resentful of the Soviet pact with Nazi Germany and especially of the Russian attack on Poland in the wake of Germany's blitzkrieg against that unfortunate country, offered minimal trade prospects. And Russia's supplier of choice—the United States—clamped a moral embargo in December 1939 on exports of aluminum, molybdenum, industrial equipment and technical advice to the Soviet Union because of the Soviet attack on Finland.

America still remained the preferred supplier of industrial equipment to Russia. Mikoyan reaffirmed this preference to an editor of *Business Week*.<sup>18</sup>

But given the unfavorable climate of Russo-American relations, Russia had to turn willy-nilly to Germany for desperately needed supplies. It was strictly a marriage of convenience; neither side had any illusions about the other.

Though Germany has become a solid second supplier of Russia's machinery imports and has absorbed much business formerly supplied by England and France, there is no intention here to replace the United States as the number one supplier of Soviet machinery, unless America raises real barriers to this trade.<sup>19</sup>

<sup>17</sup> *Ibid.*

<sup>18</sup> *Business Week*, April 6, 1940.

<sup>19</sup> *Ibid.*

Germany had to agree to provide Reds with \$250,000,000 of munitions [despite the acute Nazi war needs for the war in the West] and to sell to the Soviets two of Germany's most strategically important industrial processes—the Fisher Plan for the making of gasoline from coal, and the famous Buna process for making artificial rubber.<sup>20</sup>

In return, Russia had to supply 1 million tons of oil, 1 million tons of fodder, mainly barley, and quantities of raw cotton, manganese, sulfuric acid, etc.

*Business Week* concludes its report prophetically:

For the present, longstanding ill feeling is being pushed into the background. But each party knows that the entire Soviet-German rapprochement—political and economic—will last only as long as the present emergency.

It is chilling to scan German trade figures which reflect German "correctness" in meeting contractual obligations to Russia, while the last details were being posted by Hitler's generals to the "Operation Barbarossa" blueprint for a cosmic assault on Russia.

## IX

SOME SOVIET ECONOMISTS claim that Russia achieved her industrial greatness virtually *ex nihilo*, and deliberately belittle or negate Russia's substantial achievements prior to the Revolution. But their claims are only slightly more fraudulent than the attempts to dismiss Russia's massive achievement out of hand, by bringing up similar breakthroughs on the part of Germany and Japan. After all, Russia did not have a five-billion franc indemnity that was delivered providentially to Germany at the end of the Franco-Prussian War.

As we have seen in our survey of Russia's trade-financed industrial maturation, Russia's options were severely limited. The standard invisibles that usually bring in considerable foreign currency in other countries—tourism and emigrant remittances—were minimal. Even if we add to these the proceeds generated by Torgsin (stores for trade with foreigners, Russia's unique device for snaring foreign currencies from foreign visitors and tourists), the total would still be inconsequential compared to Russia's enormous needs of valuta.

So, demonically driven as the Soviet leaders were by the goal of industrializing Russia which they knew was the price of national survival, they perhaps had no alternative but to put the Russian people through the

<sup>20</sup> *Business Week*, June 1, 1940.

wringer for this supreme task. And as the old Donbass lay in shambles in 1941, "Stalin's ruthless foresight in creating a second arsenal, The Magnitorgorsk of 1933,"<sup>21</sup> probably saved Russian from an ultimate disaster.

And yet, the student of Russia's painful climb to industrial maturity is haunted by the possibility that the agony of transition might have been enormously eased by a judicious use of Russia's great untapped resource—gold. There is the enigma of our story.

Alexander Baykov explored this facet of the problem. Soviet statistics supplied no clue to the total production of gold. "But on the basis of the League of Nations figures, we can arrive at these estimates of the production of gold in the U.S.S.R.":

	Minimum	Maximum
1936	\$169,915,770	\$210,425,490
1937	153,036,720	189,945,360

Baykov concluded that the U.S.S.R.'s gold output in 1937 would pay for 60 per cent of all goods imported into the U.S.S.R. in the course of that year.

Russia's gold reserves were large enough to finance several years of the high imports needed to fuel her industrial growth. One conjectures that there were acrimonious debates behind the scenes at the Kremlin on this way of easing the stupendous sacrifices of the Russian people. But Stalin and his group carried the day and refrained from selling large amounts of gold, probably regarding them as a super war chest, to be used only as a last resort. In this respect, Stalin proved that he was Russian to the core. For, as Alexander Walewski wrote in his *Peter the Great*: "Russia's strength and the secret of her destiny have always in great part consisted in the will and the power to disregard costs in view of the results to be achieved."

*U. S. Department of Commerce*  
*Washington, D.C. 20230*

<sup>21</sup> Violet Connolly, *Beyond the Urals*, (London and Oxford: Oxford University Press, 1967).

*Modern Technology, Hope and Disaster*

WE ARE AT THE BEGINNING of an era to which the future will look back as to a point of genuine change in the manner in which modern technological societies sought to maintain their viability . . . What is singular about the evolution of this newest dimension of freedom is that it is so extraordinarily dependent upon the element of time. The changing ecological balance is something that mankind has never had to deal with before. This is new. It is different. This fact is indispensable to understanding the particular challenge before us. The newest dimension of freedom arises in the context of advancing technology. More accurately, it arises *from* advancing technology. First, the folk technology of the early industrial revolution and later the ever-mounting and more systematic application of scientific knowledge to practical problems has created an almost world-wide vision of societies of material plenty in which individual men become all they are capable of being. Personal liberty and democratic government would be the pre-condition of such societies, but their unique achievement would be measured by the degree to which the men and women comprising them live large, creative and fulfilling lives. And this is a very large vision indeed. The difficulty with it is that it exists in the context of time constraints that make it, for a vision, at once so powerful and extraordinarily fragile. This is so in a word, because technology that created it only hours ago in the history of mankind, threatens to destroy it only hours from now. In the past we have seen individual liberties suppressed and later revived; we have seen political liberties destroyed only to be restored undiminished by that experience. But the changing ecological balance of mankind in terms of the chemical nature of the universe, in terms of the size of the population of the universe, is such that the disasters that are upon us can become irreversible, just as the opportunities are unprecedented. This issue of the environment we regard as fundamentally serious. It has been remarked that, apart from modern warfare itself, the automobile has had more effect upon human society than any other aspect of modern life. It has quite transformed it. One aspect of that transformation has been a quite extraordinary incidence of death and injury from automobile collisions. This is not something inevitable any more than bubonic plague was inevitable. [From an address.]

DANIEL P. MOYNIHAN

# The Role of the Graded Tax in Urban Redevelopment:

## *A Case Study of Lancaster, Pa.*

By STEVEN CORD

### I

#### Purpose of the Study.

LANCASTER IS A PICTURESQUE CITY at the center of an area with a very sound economy, yet like many other cities throughout the country, it has large sections with deteriorating housing and its downtown commercial district is suffering from serious competition with a number of outlying shopping centers.

There are many ways by which the cities can meet these twin problems, one of which, Pittsburgh's Graded Tax, has been recently endorsed by many prominent urban renewal authorities. This approach has been called "the golden key to urban renewal, to the automatic regeneration of the city—and not at public expense." Other endorsers are National Association of Home Builders, *Fortune Magazine*, *Nations' Cities Magazine*, and various chambers of commerce throughout Pennsylvania. This is, of course, only a partial list. The Graded Tax, then, should merit the attention of all those who wish to improve their city.

It is interesting to note that Hawaii has recently adopted the Graded Tax after having studied Pittsburgh's experience with it. The idea has worked successfully in Australia, New Zealand, the California Irrigation Districts, Fairhope, Ala. and Arden, Del. Three cities in western Pennsylvania are currently giving the Graded Tax serious consideration, and the State of Vermont has just shown recent and enthusiastic interest in it.

Construction is the most heavily taxed industry in America. This is undoubtedly one important reason why it needs so much governmental help to meet the needs of its customers, while other industries do not. The Graded Tax would make it possible to considerably untax improvements.

For all these reasons, the city of Lancaster has found it advantageous to inform the Department of Housing and Urban Development of its interest in adopting the Graded Tax when submitting its application for admission to the Model Cities Program.

What is the Graded Tax and how does it work? It is a modification

of the current property tax. At the present time, the tax assessor assesses both land and building, each according to their respective values; this would not change under the Graded Tax. Then the city determines the tax rate—*i.e.*, the millage (mills per dollar, a rate equal to the tax charge per thousand dollars of valuation) which will yield a tax revenue from all taxable properties which will suffice to meet city expenses. Here is where the Graded Tax differs from the current property tax: instead of taxing land and building at the same tax rate, the city would gradually decrease the tax rate on buildings while gradually increasing the tax rate on land. The city would continue to get the same revenue as before from the new property tax, except that it would get proportionately more from land and proportionately less from buildings. Instead of one tax rate there would be two.

The advantages claimed for this Graded Tax are:

(1) *An increase in housing and new construction.* If improvements are untaxed, there will be more of them. Also, the cost of owning improvements is reduced considerably and eventually space rentals will be reduced.

(2) *More efficient land use.* It would be difficult to keep land out of use, or only partially used, if the land is taxed.

(3) *A fairer tax system.* Government services increase land values and therefore the government should tax land values rather than what individual initiative creates (namely, buildings and income).

If Lancaster adopted the Graded Tax, would it reap these advantages? What would be the effects of the Graded Tax in Lancaster? It is the purpose of this study to answer these questions. A sample was developed of more than one hundred properties, reflecting the property picture of the city at large. Land and building assessments were determined for each property (from the city assessment records) and the properties were classified according to type of property so that the effect of the Graded Tax on each type of property could be ascertained.

This study was authorized by the city government of Lancaster and financed by a grant from the Lincoln Foundation, a non-profit organization interested in research in municipal government and finance.

## II

### Proposed Graded Tax Schedule for the Next Five Years

PENNSYLVANIA LAW CLEARLY AUTHORIZED CITIES like Lancaster to follow Pittsburgh's lead (also Scranton's) and adopt the Graded Tax. As far as the school tax is concerned, there is no law requiring a uniform tax

rate on land buildings, but neither is there any law authorizing local option on different tax rates.

Since the purpose of the Graded Tax is to improve land use by inducing certain landowners to improve their property, time must be allowed for this to occur. Otherwise these landowners would be put at an unfair disadvantage. Hence, instead of introducing a considerably larger tax rate on land and a lighter one on buildings all in one fell swoop, this should be done gradually over a five year period. Anyone contemplating adjustments would then have time to make them.

At the present time, the city would plan to maintain a 75 per cent-25 per cent ratio on buildings; that is, it should consider eventually exempting 75 per cent of assessed building values from taxation, leaving 25 per cent to be taxed. If the city does this, the following schedule of tax rates under the Graded Tax could apply:

Year	Reduction in Building Tax Rate (per cent)	Building Tax Rate (mills)	Land Tax Rate (mills)
Current	0	12	12
Second	25	9	33.1
Third	50	6	54.2
Fourth	75	3	75.3

These tax rates for both land and buildings are calculated on the assumption that land and building values would remain approximately the same during the five year transition period, and that the city budget requirements would not be materially increased or reduced. Since some variation is to be expected, actual millage rates can only be determined by the City Council from year to year. In the event of a material increase in either land or building values, the millage rates could be adjusted accordingly.

### III

#### *Effects of the Graded Tax on Different Types of Property*

NO SURVEY IS NEEDED to realize that empty lots would be taxed more heavily under the Graded Tax than under the present property tax. The bigger and the more centrally located lots would naturally bear the heaviest taxes.

Owners of such lots would have two choices: build or sell out to builders. Either choice would be socially desirable as there still is a shortage

of good housing in Lancaster. Zoning should be employed to prevent over-building. While there is a need for small in-town parks (sometimes called mini-parks or vest pocket parks), certainly empty lots are not the answer.

Compared to the present property tax, the Graded Tax would make it easier for owners of empty lots to build because the improvements they erect would be taxed much less. It should be remembered that a 3 per cent annual tax on improvements is equivalent to a 50 per cent excise tax on new construction. At the same time the Graded Tax would exert pressure on owners of empty lots to build, it would make it easier for them to do so.

Taxes would decrease on single family, unattached homes. The savings would be substantial for two classes of homeowners: those living in well-maintained homes (the better the maintenance, the bigger the tax saving) and those whose homes are situated on land that has lost value because it fronts on truck routes, busy highways or gas stations. Only one home would receive no tax saving at all, and that was a well maintained home on State Street. The neighborhood is very desirable and the high land value precluded any real gain by a switch to the Graded Tax. In general, these findings are corroborated by studies made in other cities.

It can be predicted that the long range effect on private housing in Lancaster must be: first, to increase the supply of houses because they would be cheaper to build and maintain (taxes are a substantial cost factor in home ownership), and secondly, to make rehabilitation easier. Both effects are desirable because Lancaster will be needing more housing in the coming decade because of a predicted increase in population and because there are already too many overcrowded houses in the city. Also, many housing units in Lancaster are quite old and in need of repair. Today, a \$3,000 repair job will incur an increased assessment, and then an increased tax amounting to approximately \$20 a year ( $\$3,000 \times .55 \times .012$ ; \$20 a year is equivalent to \$400 in hand and this must be added to the original cost of \$3,000). The current property tax inhibits home improvement as compared to the Graded Tax.

Taxes would decrease even more substantially on attached homes (row houses). For cities the size of Lancaster, this represents an efficient use of land.

Attached homes with stores on the ground floor would tend to have the highest tax savings under the Graded Tax, and there would be a slight tendency for the best maintained attached homes to receive the biggest tax savings. But this was negated to some extent because such homes

tended to be in desirable neighborhoods where land assessments were relatively high.

One pleasant surprise this survey uncovered was that attached homes in Negro neighborhoods would receive substantial tax benefits under the Graded Tax. In these neighborhoods rentals were relatively high<sup>1</sup> and there would be comparatively less Graded Tax to pass on to tenants in the form of higher rentals.

There would also be long range effects of the Graded Tax. It should tend to increase the overall housing supply and it should make compliance with housing code enforcement much cheaper and easier.<sup>2</sup>

Multi-family houses would receive tax relief under the Graded Tax. Apartment houses would be the biggest gainers of all. At first this would redound to the benefit of the owners, but the gains would be so substantial as to give tremendous impetus to new apartment construction. From the viewpoint of city planning, this would be highly desirable because only in this way will the stores in the central business district be able to meet successfully the increasing competition from the shopping centers soon to be ringing the city. If people want lawns to mow in suburban setting, they cannot expect to do this on city land. Cities exist to bring people together, not to spread them thinly about. City amenities can only be maintained among a fairly dense population. However, apartment living requires planning for a number of small parks within city limits. Such parks, if well planned could cost less than the increases in the taxable land value they would create.

Would apartment house tenants be paying lower rentals under the Graded Tax? This survey can offer no answer to this interesting question, although the economics textbooks are quite agreed that taxes on buildings are eventually passed on to tenants (under the Graded Tax, such taxes would be reduced) but the tax on land must be paid by the landowner.

Rooming houses would receive mild tax benefits. This was not anticipated. Only those rooming houses situated near the central business district with land values inflated as a consequence, would not receive such benefits. Presumably these benefits would eventually bring about a reduction of rooming house rentals, a not untoward effect in view of the low incomes of most such renters.

It will be noted that the Graded Tax generally would bring tax savings

<sup>1</sup> See the Lancaster Housing Study of 1966.

<sup>2</sup> A recent study in Dayton, O., confirms this.

to owners and tenants of residences. This is because residential land is inexpensive compared to commercial land.

Office buildings must generally be located in certain desirable downtown locations, and although they would be taxed less heavily by the Graded Tax, this would generally be more than offset by a higher tax on the land value. This is true even for the Griest Building, certainly a well-developed structure, although in this case the increase in tax would only be minor.

Some of Lancaster's office buildings seem to be in need of rehabilitation, and it must be noted that the Graded Tax would measurably reduce the taxation on such expenses.

Aside from a few store properties not within the central business district, store properties would pay more under the Graded Tax than under the current property tax. A central business district location presents tremendous opportunities for retail businesses, and it could be expected that the city which created such values should tax such values.

It is important to realize that it will not be the expense of operating stores that will be increased but rather the expenses of owning central business district property. In some cases, central business district stores own the property in which they are doing business, but this is not always so. Since the Graded Tax will reduce the building tax, an expense passed on to store owners in the form of higher space rentals, it is reasonable to expect that eventually retail space rentals would decrease, a fact which might commend the change to central business district store owners.

The higher Graded Tax rate in the central business district would have some indirect advantages for the retailers there. In the first place, repairs and rehabilitation would be cheaper because they would be considerably untaxed. This would encourage the central business district improvement which would stave off the growing blight afflicting so many other American cities.

Secondly, the prime effect of the Graded Tax would be to encourage the construction of high-rise apartment houses on the fringes of or near the central business district. This eventually would increase the sales and profits of central business district stores. If the city continues to lose its high and middle income population, no amount of retail tax relief can help the central business district stores. This emigrating population will increasingly shop in the rim shopping centers, draining trade away from the central business district. If they can be encouraged to stay or if their numbers can even be increased, it will be much more convenient for them

to shop in the central business district rather than in outlying areas. Such a population development would decrease traffic coming in and out of the city and would make in-city public transportation more feasible.

There are many reasons why high and middle income families are leaving the cities, but for the sake of central business district store owners, public tax policy should seek to slow down or even reverse such a population trend. The future of the central business district depends largely on this population factor.

Another possible long-term effect of the adoption of the Graded Tax might be the smoothing out of land prices throughout the central business district. At the present time, land prices fall off sharply as one moves away from Penn Square. The sharpness seems unnatural and one can see how the Graded Tax would encourage a more even development of the central business district.

The effect of the Graded Tax on industry will vary. But by and large industry will receive substantial tax encouragement. This is especially true if a factory is not located too near the central business district and is not in an old building (also if it makes intensive rather than extensive use of the land). Factory sprawl will be discouraged and so also would be factories near the downtown area.

This tax benefit should be of interest to corporations considering Lancaster as a possible location for a new factory. However, this tax benefit will not in any way decrease the total tax revenues of the city, as do some other forms of tax benefits to industry.

This tax benefit should also encourage the expansion in Lancaster of existing factories, and also their repair and rehabilitation. The growth of new and indigenous factory operations would be spurred.

The Graded Tax impact would vary for other miscellaneous improvements. The Hotel King Douglas (Lancaster's only hotel now) would benefit as would certain warehouses situated in low-land-value neighborhoods. But downtown warehouses, junkyards, and parking lots would be discouraged. (Other cities have found that municipally-owned parking lots in the interior of city blocks can be operated successfully at break-even profit.) Most gas stations, especially those in the downtown area, would receive tax increases.

Fortunately, this impact would encourage city development in line with modern urban planning goals. Downtown warehouses, junkyards, parking lots and gas stations represent an inappropriate use of central business district land and should be discouraged by the property tax system.

## IV

## Assessment Procedures

THE LAST LANCASTER PROPERTY VALUATION for tax purposes was drawn up in 1960. Property values have changed considerably since then and the city might very well consider another valuation. City property is supposed to be assessed at 55 per cent of market value, but much property is assessed much lower than that. It is also probable that land values are assessed lower than building values. Contrary to Graded Tax principles and modern city planning, land used commercially is assessed 50 per cent higher and vacant lots are under assessed by as much as 50 per cent or more. A new valuation seems in order.

A new valuation would probably reduce the present 7:1 building to land value ratio for the city as a whole. This would in turn result in a slight alleviation of the taxes central business district property would pay and raise slightly the taxes on residential uses in and near the central business district.

The Graded Tax could be applied using the present assessed values, but its effectiveness would be enhanced if more accurate assessments were used.<sup>3</sup>

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<sup>3</sup> In an appendix to this article, the author presents six pages of factual data upon which the findings are based. It consists of assessment data from records of the City of Lancaster, Pa. Table I shows the incidence of the Graded Tax on a representative sample of real estate properties in Lancaster. For each address the following information is given: building assessment, land assessment, building/land ratio; selling price and date of sale; city tax at a rate of 12 mills; Graded Tax, first year; the amount by which the city tax exceeds or falls short of the Graded Tax, and a description of the property. Properties are presented in the following categories: empty lots; single family (homes); attached residences; apartment buildings; office buildings; store properties; industrial and miscellaneous. Table 2 shows the incidence of the Graded Tax on a small representative sample of real estate properties in Lancaster at the end of one, two and three years, at the following rates: 9 mills on buildings, 13.1 mills on land; 6 mills on buildings, 54.2 mills on land; 3 mills on buildings, 75.3 mills on land, compared to the present rate of the city property tax of 12 mills on land and buildings.

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## Beyond Positive Economics

By LEWIS E. HILL

IN A PREVIOUS ARTICLE,<sup>1</sup> positive economics was criticized both because it denies the legitimacy of economic value judgments and because its positive verification procedure is too limiting and too restrictive. It was argued that economic value judgments are necessary and desirable to give economic theory meaning and significance for practical problems of economic policy. Furthermore, it was argued that implicit value judgments are inevitably implied by positive economic theory and that academic honesty and responsibility demand the explicit recognition and statement of implicit value judgments.

The positive verification procedure was criticized because it can be legitimately applied only to quantifiable real conclusions, as distinguished from qualitative and hypothetical conclusion. For this reason, positive economics is inconsistent with the hypothetical conclusions of partial and general equilibrium analysis. A much more important criticism of the positive verification procedure held that, although positive economics is capable of making reliable predictions, it is completely incapable of explaining why the predictions are fulfilled—incapable of providing a thorough understanding of the cause and effect relationship between precedent conditions and predicted events. Prediction involves a correlation between two variables separated by a time lag. But, as every elementary statistics textbook indicates, correlation does not necessarily imply causation. For these reasons, positive economics was accepted as a valid but very limited methodology. Positive economics was rejected as a denial of the legitimacy of economic value judgments.

In the previous article it was suggested that the limitations of positive economics might be overcome through either of two approaches: John Dewey's pragmatism, which has been applied to institutionalist economics by C. E. Ayres, and Michael Polanyi's theory of personal knowledge. The purpose of this paper is to go beyond positive economics and to explore each of these approaches to overcoming the limitations of positive economics. Both the Dewey-Ayres approach and the Polanyi approach will be summarized and an attempt will be made to integrate these approaches into a synthesis which will provide a more generally applicable and, therefore, a much more useful methodology for the economic science.

<sup>1</sup> Lewis E. Hill, "A Critique of Positive Economics," *American Journal of Economics & Sociology*, Vol. 27 (July, 1968), pp. 259-66.

## I

## John Dewey's Pragmatism and C. E. Ayres' Institutionalism

A MINORITY OF American economists have sought in pragmatism an alternative to positivism, and in institutionalism an alternative to positive economics. This minority has attempted to find in pragmatism and institutionalism the solution to the problems posed by positivism and positive economics; but the attempted solution has been abortive, partly because the majority has been so firmly wedded to the positive methodology, and partly because of inherent weaknesses in pragmatism and institutionalism.

Pragmatism is an epistemology which holds that all realities have practical consequences; therefore, we can know reality through a consideration of these practical consequences. The pragmatic method is to interpret a concept, proposition, or idea by tracing its practical consequences. Pragmatism is radical empiricism. It is anti-metaphysical and anti-rationalistic; it denies the existence of ultimate, transcendent, or intrinsic knowledge and truth. All truth is reduced to an operational or instrumental level. Pragmatists believe that any idea which is useful to us in relating one part of our experience to another is true instrumentally; they hold that we believe an idea is true if it is profitable for our lives. Truth becomes mere expediency in our way of thinking, just as ethical or moral right becomes mere expediency in our way of behaving.<sup>2</sup>

Pragmatists are less rigorously theoretical and more tentatively empirical than positive economists; and they use a more liberal and flexible standard of verification. Pragmatists shift the emphasis away from economic theory toward economic policy, and away from formal theoretical models toward informal experimental methods of trial and error. As a result of these differences, the pragmatic theories of institutionalist economics have a general empirical applicability, which can never be achieved by a rigorously consistent positive theory.<sup>3</sup>

The greatest innovation of pragmatic economists, however, is their willingness, even eagerness, to make value judgments according to John Dewey's instrumental theory of value. Dewey holds that there are two kinds of value judgments: judgments about everyday experience; and judgments about eternal and transcendent things. He accepts the former but rejects the latter. "Judgments about values," he insists, "are judgments about the conditions and results of experienced objects."<sup>4</sup> The change in the basis of value judgments from preconceived transcendent

<sup>2</sup> William James, "What Pragmatism Means" and "Pragmatism's Conception of Truth," *The American Pragmatists*, edited by Milton R. Konvitz and Gail Kenedy, (New York: Meridian Books, Inc., 1960), pp. 28-61.

<sup>3</sup> John Dewey, *The Quest for Certainty: A Study in the Relation of Knowledge and Action* (New York: G. P. Putnam's Sons, 1960), pp. 74 ff.

<sup>4</sup> *Ibid.*, p. 265.

ideals to a knowledge of consequences has several important effects on the value judgments: first, it shifts the basis of value judgment from the past to the future; second, it validates subjective value judgments; and, third, it makes value a matter of flexible and tentative hypothesis, which is subject to verification and alteration.<sup>5</sup>

Professor C. E. Ayres, the distinguished institutionalist economist, has developed a system for making value judgments on the basis of the consequences on the technological life process. He explains his theory thus:

Doing-and-knowing, science-and-technology, is the real life process of mankind. This is the process from which modern industrial civilization has resulted, and it is the process in terms of which men have always judged things good or bad, and actions right or wrong. . . . This life process is the matrix from which all genuine values—as distinguished from sentimental fancies—derive their meaning.<sup>6</sup>

In this manner, Ayres dissolves the artificial distinction between means and ends and bases every economic value judgment upon the practical consequences of the judgment upon the technological or instrumental process through which we have maintained life and improved our level of living.

The pragmatic approach of the institutionalists solves some of the epistemological problems of positive economics. For one thing, pragmatists do not adhere to the rigorous verification principle of the positivists; therefore, pragmatic verification procedures are less limiting and less restrictive than positive verification procedures. For another thing, pragmatists are willing and able to make sound value judgments which can be incorporated into their economic theory. Nevertheless, pragmatic institutionalism has never had really significant influence, and, in recent years, even the slight influence that it once enjoyed seems to have waned seriously. One reason for this may be a bias among economists in favor of positivism and against pragmatism and institutionalism. Certainly, positive economics has basked in the reflected glory of the natural sciences, whose method has been associated with positivism; and pragmatism and institutionalism have suffered from alleged radicalism. The other reason may be inherent weaknesses in pragmatism and institutionalism. It is sometimes erroneously alleged that institutionalism is devoid of theory, but this is not true. It is true that institutionalists have used their theory negatively and critically, rather than affirmatively and creatively; as a result, institutionalists have produced more destructive criticism than constructive proposals. Furthermore, the pragmatic epistemology is strangely

<sup>5</sup> *Ibid.*, pp. 272-77.

<sup>6</sup> C. F. Ayres, *Toward a Reasonable Society* (Chicago: Markham, 1934), pp. 11-12.

superficial. By making all truth operational they have denied the existence of ultimate, transcendent, or intrinsic truth; by making all values instrumental, they have minimized the meaning and significance of value. It is perhaps not too harsh to assert that pragmatists have found truth by denying its existence, and that they are willing to make value judgments only because they minimize the significance of value.

## II

### Michael Polanyi's Theory of Personal Knowledge

THE OTHER APPROACH which offers a practical alternative to the limitations and restrictions of positive economics is Michael Polanyi's theory of personal knowledge.<sup>7</sup> Michael Polanyi is a distinguished scientist who has become an equally distinguished philosopher. He first developed his theory of personal knowledge as a philosophy of science and later expanded it into a comprehensive and definitive theory of knowledge. Polanyi has applied his theory of knowledge to the social sciences and has developed it into a philosophy of history. While Polanyi has not applied his theory of knowledge specifically to economics, it is applicable to economics where it offers a high hope that the economic science may yet break out of the limitations and restrictions of positive economics.

Polanyi starts with the presumption that we know more than we can tell. For example, we know how to swim and how to ride a bicycle, but we cannot tell another person how to perform the complex muscular and sensory operations involved in these skills. These examples illustrate Polanyi's distinction between focal awareness of a whole and subsidiary awareness of its components. Polanyi then develops the related concepts of explicit and personal knowledge. Explicit knowledge refers to the explicit inferences which can be drawn from the knowledge of which we are focally aware. All other knowledge is tacit or personal knowledge. Examples of personal knowledge can be drawn from all levels of human mental faculties ranging from learning preverbal bodily operations, through learning the meaning of language and understanding all explicit knowledge, to the acts of genius required to comprehend genuine novelty.<sup>8</sup>

The fact of personal participation in the act of comprehending personal knowledge does not deprive the knowledge of its validity; indeed, personal knowledge may be more fundamentally valid than explicit knowledge. Personal knowledge is based upon faith or belief, rather than reason, and it is accredited as valid by the believer's responsible

<sup>7</sup> Michael Polanyi, *Personal Knowledge: Toward a Post-Critical Philosophy* (New York: Harper and Row, 1964).

<sup>8</sup> *Ibid.*, pp. 49-131. Michael Polanyi, *The Study of Man* (Chicago: Univ. of Chicago Press, 1959), pp. 11-39.

act of personal commitment. The calling of literate man is to seek the truth. This calling is a transcendent obligation imposed upon man by the existence of truth and by man's ability to find it. The responsibility to seek the truth calls into play the intellectual passions, which conflict with the physical passions; therefore, the pursuit of truth requires a personal discipline which is necessary to the validity of the truth. If a person is true to his calling as literate man, and if he engages in a disciplined and responsible quest for truth, then he accredits as valid any personal knowledge to which he responsibly commits himself.<sup>9</sup>

Ultimately, the validity of all explicit knowledge is based on tacit assumptions and preconceptions. Preconceived personal knowledge is an absolutely necessary condition to the accumulation, the statement, and the understanding of all explicit knowledge, including all explicit scientific knowledge.<sup>10</sup> Polanyi is firm in his insistence that the social sciences must include normative value judgments in order to meet the needs of the modern age. Indeed, he believes that the refusal and failure of many social scientists to make firm and sound normative value judgments has intensified and compounded the unrest, anxiety, and turmoil which has characterized recent history.<sup>11</sup> The validity of a normative value judgment, like all personal knowledge, is based upon a responsible personal commitment to the judgment. If you are responsibly committed to your value judgments to such an extent that you are willing to accept the consequences of asserting their truth, regardless of what these consequences may be, then you are privileged to make your value judgments and to assert their truth. All explicit knowledge must be based upon tacit or personal knowledge; and all tacit or personal knowledge must be based upon responsible personal commitment.<sup>12</sup>

What are the implications of Polanyi's theory of personal knowledge for economic science? Polanyi does not question the validity of positivism as a method of verifying explicit inferences; but he does imply that economics should go beyond this into consideration of variables which cannot be quantified and of conclusions which cannot be verified by the positive principle of verification. He further implies that the whole meaning and significance of economic science depends upon the normative value judgments to which responsible economists are personally committed.

<sup>9</sup> Polanyi, *The Study of Man*, op. cit., pp. 12-20.

<sup>10</sup> Michael Polanyi, *Science, Faith, and Society* (Chicago: Univ. of Chicago Press, 1964).

<sup>11</sup> Michael Polanyi, "On the Modern Mind," *Encounter*, May 1965, pp. 12-20. Michael Polanyi, "The Message of the Hungarian Revolution," *The American Scholar*, Vol. 35, pp. 661-76.

<sup>12</sup> Polanyi, *The Study of Man*, op. cit., pp. 12-20. *Encounter*, May 1965, pp. 12-20.

While Polanyi correctly contends that all personal knowledge, including normative value judgments, may be valid and is the necessary basis of all explicit knowledge, he unfortunately fails to provide a scientifically operational method of verification for personal knowledge. Personal knowledge is so very personal that there is no assurance that your personal truth is the same as my personal truth, or that either your personal truth or mine is ultimate truth. Thus, while Polanyi has given the concept of knowledge great breadth and depth, it is difficult to see how his concept can be made operational in any scientific methodology.

### III

#### Beyond Positive Economics

THE FAILURE OF THE PRAGMATISTS and institutionalists is their refusal to recognize ultimate truth. The pragmatic emphasis on means and consequences implies the existence of some ultimate end or purpose. It is only in terms of some ultimate end or purpose that the immediate means and consequences have meaning and significance. When Ayres writes of the "life process," he is developing his concept of ultimate truth. If the technological "life process" is not an ultimate value, then the institutionalist emphasis on technology and technological behavior becomes nonsense.

The failure of Michael Polanyi is his inability to develop a scientifically operational verification procedure for personal knowledge. Polanyi has failed to see that truth is pragmatically self-authenticating in history. If your value system meets the needs of your life and solves your problems of living from day to day, then the truth of your value system has been pragmatically authenticated in your personal history or biography. In a similar manner, if the predominant value system of a society meets the needs of that society and solves the problems which that society encounters in history, then the truth of the value system has been pragmatically authenticated in the history of the society. Thus, ultimate truth tends to be pragmatically self-authenticating in both personal and social history.

The whole purpose of this paper is to suggest that the best hope for going beyond the limitations and restrictions of positive economics lies in the possibility of a synthesis between the operational but superficial pragmatism and institutionalism of the Dewey-Ayres group and the deeply profound but operationally vague philosophy of Michael Polanyi. The distinguished anthropologist, Jacob Bronowski, seems to be working in this area. We can fervently hope that he will succeed in working out the synthesis, and that his synthesis will then be applied to economic science.

## *In Memoriam: Neil MacNeil, 1891-1969*

NEIL MACNEIL, the journalist, author and publicist who died in Southampton, L.I., where he made his home, on December 30, 1969, was one of a small group of distinguished men and women who gave immediate backing to the *American Journal of Economics & Sociology* when it was founded in 1941 and was a strong supporter of the scholarly venture throughout the remainder of his lifetime. But this was only one of a number of good causes to which he dedicated his life.

Mr. MacNeil was one of the chief figures in the effort by Herbert Hoover and his close friends to modernize the American government by reorganizing it to meet the needs of the present and future and to make it more responsive to the will of the people. He was also one of the leaders in the effort to make American and indeed world journalism more responsible and a better means of keeping the electorate informed and thereby strengthening and extending democratic institutions. He gave ardent support to his old college, St. Francis Xavier University in Antigonish, Nova Scotia, first in its effort to bring about democratic social reform in Nova Scotia through producer and consumer cooperatives and credit unions and later, when the program had proved itself, to make the university's facilities available to the poverty stricken victims of privilege and monopoly throughout the world. These efforts indicate the range of his interests but the list is only a partial one.

Neil MacNeil was born in Dorchester, Mass., on February 6, 1891, the son of John MacNeil (a building contractor who constructed very large projects in various parts of the United States and Canada) and the former Katherine MacNeil. He and his brother were brought up by their grandfather on the ancestral farm in Washabuckt, N.S. His was a legendary boyhood in the farming community, little changed from the 18th century, by the Bras d'Or Lakes, chronicled affectionately in one of his books, *The Highland Heart in Nova Scotia*. The grandfather, he records, nurtured in the boys "the rare and mysterious mixture of pride and simplicity, of pugnacity and kindness, that makes the true Scot." A true Scot, indeed, was Neil MacNeil.

Mr. MacNeil graduated from St. Francis Xavier in 1912, worked briefly as an insurance salesman, then entered journalism as a cub reporter on the *Montreal Daily Mail*. In 8 months he was city editor. In 1913 he joined the staff of the *Gazette* in Montreal, which in 1917, along with the *Toronto Globe*, appointed him New York correspondent. In 1918 he joined the staff of the *New York Times* as copy editor. He became foreign editor in 1926, night city editor in 1927 and from 1930 until his retirement from the *Times* in 1951, he was assistant night managing editor, a key news executive.

He was well launched on a second career as an author in 1954 when former President Hoover persuaded him to become editorial director of the Hoover Commission. When the agency brought out its final reports and began the nonpartisan fight to win implementation of its recommendations Neil MacNeil was its top executive. Meanwhile he was editing the Hoover books which the former president was turning out to earn royalties for his chief interest, the Boys Clubs of America. Like MacNeil's own books (the wartime *An American Peace*, which foreshadowed the Marshall Plan and American postwar aid for the development of the less developed countries, his journalism textbooks and his history, with Harold W. Metz, of the commission, *The Hoover Report, 1953-1955*) the works Neil MacNeil induced Mr. Hoover to turn out were permanent contributions to American literature. This service he continued to render as one of Mr. Hoover's three literary executors after the former President's death in 1964.

Perhaps I may be permitted a personal word. I joined the *Times* five years after Neil did, as a boy of 15, and we soon, despite the difference in our ages, became close

friends. That friendship lasted for Neil's lifetime. He and I were among the first students at Alvin Johnson's "University in Exile." Among the most enjoyable times of my life have been vacations spent with Neil and Elizabeth, his wife, particularly one where we explored the Jefferson country together to pay tribute to a common hero. Neil MacNeil added a touch of genius to everything in which he became involved. This was particularly true of his friendships: he was gruff, hearty and the soul of generosity. But more than everything else—and this was not at all apparent—he was compassionate. He identified with the poor, the unfortunate, the handicapped not in the phony way of the hung-up "radicals" but in a wholly natural, understanding way. And so he dedicated himself to helping those who lacked his advantages win them by their own efforts.

A true radical liberal, Neil MacNeil was a key member of the Francis Neilson Coterie, the weekly gathering at Francis Neilson's home of men and women active in the arts and profession in the 1940s and 50s. He added to its deliberations a salty humor and a tradition of dedication to the protection and extension of individual and collective liberty that he inherited from forbears who rather than compromise with political and religious persecution, left farms and ships in Scotland for penniless pioneering in bleak Nova Scotia. But, as is well known by his wife and children to whom we extend our deepest sympathy and by the members of the Hoover circle who share our loss, what the members of the Coterie valued most in Neil MacNeil was the wholehearted way in which he gave his love and affection to family, friends, associates in professional and scholarly enterprises and to ideas and movements, like the Henry George movement for achieving a just social order by establishing equality of opportunity, or the Catholic Worker movement for helping the selfish and self-indulgent to overcome their problem by becoming involved with the afflicted.

Neil MacNeil was a giant of a man, and not only physically—in mind, in soul . . . and in heart.

WILL LISSNER

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## Programs for the Economic Development of the American Negro Community:

### *The Militant Approaches*

By WILLIAM L. HENDERSON *and* LARRY C. LEDEBUR

#### Introduction

AMERICAN CULTURE HAS DEMONSTRATED a capacity to assimilate people from diverse national minorities. However the Negro has not been integrated successfully into our social, political or economic structure. Earlier patterns of action to move the Negro into the institutional structure of American society have achieved limited objectives. Recent programs legislated by governments and those undertaken by civil rights organizations have progressed slowly in achieving social, political and economic equality for the Negro.

#### I

##### The Focus on Economic Development

BAYARD RUSTIN ARGUES that, in view of the existing social situation and current phase of the civil rights movement, the Negro effort must focus on the problem of economic advancement for the Negro.

The problem before us in this . . . period is basically an economic one. It is economic in that the objectives of the first two periods while not completed are completed enough that a dynamic cannot be created around them.

It is not possible for Negroes to gain economic independence unless the problem of poverty is dealt with. If the civil rights movement does not concentrate basically on economic issues, freedom for Negroes in our time will never be achieved.

... true freedom must be conceived in economic categories. The economy is the bone, the social institutions are the flesh, the political institutions the skin which grows on that bone and flesh. Ultimately, all human freedom is determined by the economic structure of the institution.<sup>1</sup>

The strategy that is now receiving priority among most Negro leaders of national organizations is Black economic development or Black capitalism. The Negro has identified the economic system with its capitalistic elements as a major source of power—power from which they believe they have been systematically excluded. Thus economic institutions and related ideological bases may be viewed as a central obstacle to emancipation of the Negro:

... ten years ago when the militants criticized the system, they were talking about the political system. Today when they are talking about the system, they are talking about the economic system. They have seen through the controls that the economic system exerts over the political.<sup>2</sup>

From the conservative National Urban League and National Business League to the militant Congress of Racial Equality, members and leaders now assume that the Negro must participate in the ownership, control, management and operation of the economic enterprises of this country and that if blocked in his efforts by the present institutional structure, then the economic system must be restructured. Many organizations are already prepared to achieve economic power outside of our existing economic institutions.

Some civil rights organizations (National Association for the Advancement of Colored People and Urban League) retain the older and traditional interest in jobs and skills training but most organizations have adopted fresh approaches. New directions are found in current policies of most conservative Negro organizations as well as the Black militants. Berkeley G. Burrell of the National Business League maintains that:

Certainly jobs are an essential part of the cure for our urban ills, but they must not be considered the sole palliative to the sickness. We had full employment of the hard core under slavery. Today we want a piece of the action in the mainstream business system. The jobs now being provided by sincere and well meaning white businesses serve only to provide a sense of "slave security" that will only result in greater frustration, bit-

<sup>1</sup> Bayard Rustin, "Funding Full Citizenship," *Council Journal*, 6 (December, 1967), p. 7. The two periods referred to are: (1) the period of legal action in the courts which culminated with the 1954 decision, and (2) that of the civil rights marches and sit-ins to obtain compliance with the law.

<sup>2</sup> F. Nailor Fitzhugh, vice-president, Pepsi-Cola, Inc., personal interview, New York City, July 18, 1968.

terness and rancor, destruction, and retribution in the days that lie ahead.<sup>3</sup>

A similar view is presented by William Morris, director of housing programs for the NAACP.

It is not enough simply to provide jobs, jobs, jobs, where people are being employed by someone else; and perhaps limited as to how far they can go in the upward path. . . .<sup>4</sup>

The position of the Congress of Racial Equality also illustrates the prevalent attitude of militant organizations.

Economic development takes priority over jobs per se at this point. A number of years ago our basic drive was for jobs. We have looked upon this as a way of solving the problem. We thought that was the answer. Based on the economic reality of our situation, jobs and that kind of income cannot reduce the gap, or cannot even keep it from getting any broader. We must have part of the kind of income that comes from the possession of the tools. And the kind of income that comes from being the one who receives the dividends. Our goal is economic development based upon this rationalization. That is the only answer to keeping Black people from becoming a totally dependent population.<sup>5</sup>

Economic integration through jobs and skills training is no longer receiving priority in the Negro actions for economic and social equality. The primary and current orientation in the quest for economic participation is the drive for Black ownership and control of economic resources, or Black capitalism.<sup>6</sup> Given this economic goal of establishing a viable Black economic base, the choice of strategy becomes dominant. What is the most effective means of establishing Black entrepreneurial ability and Black businesses?

<sup>3</sup> Berkeley G. Burrell in a speech presented at the Business Opportunity Workshop for Industrial Procurement, Bethpage, New York, May 24, 1968, p. 5.

<sup>4</sup> William Morris, personal interview on July 17, 1968 at the NAACP national headquarters in New York City.

<sup>5</sup> Kermit Scott, program director for CORE, personal interview at the CORE National Convention in Columbus, Ohio on July 8, 1968.

<sup>6</sup> President Richard M. Nixon has endorsed the concept of "Black Capitalism": "For too long, White America has sought to buy off the Negro—and to buy off its own sense of guilt—with ever more programs of welfare, of public housing, of payments to the poor, but not for anything except for keeping out of sight: payments that perpetuated poverty, and that kept the endless, dismal cycle of dependency spinning for generation to generation." (p. 2). "It's no longer enough that White-owned enterprises employ greater numbers of Negroes, whether as laborers or as middle management personnel. This is needed, yes—but it has to be accompanied by an expansion of Black Ownership, of Black capitalism. We need more Black employers, more Black businesses." (p. 9). "If our urban ghettos are to be rebuilt from within, one of the first requirements is the development of Black owned and Black run business. The need is more than economic. Black ownership—of homes, of land, and especially of productive enterprise—both symbol and evidence of opportunity, and this is central to the spirit of independence on which orderly progress rests." (p. 16). (Richard M. Nixon, "Bridges to Human Dignity," an address on the CBS Radio Network, April 25, 1968).

## II

**Strategy for Development**

IN ATTEMPTING TO GET the power associated with the control of economic resources, the Negro faces an ideological dilemma when he tries to discover effective approaches. This dilemma is illustrated by the polar case options that seem to be available to the Black. The Black must push either for integration within the existing economic institutions or for some form of economic separatism. The choice of strategy depends upon the alternatives available. One course of action would institute Black businesses within the established economic community. Here fledgling Negro businesses and entrepreneurs would face the competition across the color line. The risk factor to new Black businesses in attempting to establish a bi-racial economy is extremely great.

The alternate course is to establish a Black economic substructure. Black businesses would cater to a market composed of Black consumers or to the ghetto areas of the inner city. The risks involved in this line of attack are also extremely high. The Negro market is limited by the low level of its purchasing power. The attempt to establish Black businesses of any large scale is constrained by inadequate demand for the product or services being marketed. It is difficult to establish a self-sufficient Black economy in the midst of a highly integrated White economic system. It is necessary to maintain linkages with the established economic system, particularly to supply needed capital funds and raw materials.

In extreme form the separate economic system alternative has a geographical dimension. Where should the separate and self-sufficient Black society and supporting economic structure be established? The separatist alternative is advocated by Black nationalist organizations such as Black Muslims, Black Panthers, and others.

## III

**Economic Separatists—The Militant Approach**

THESE ORGANIZATIONS HAVE CONTINUED a well established pattern of emphasizing separation by a minority of Blacks. The historical precedents for Black separatist movements can be found in the Niagra Movement, Marcus Garvey's undertakings, recommendations by Frederick Douglass and the more recent pronouncements of the Black Muslims. The older and more modern separatist concepts, however, are not homogeneous and differ as to the geographical focus, the time span for implementation and, of course, the strategy for achieving the separate entity status.

The modern separatist movements are more relevant in their reflection of the root economic causes that motivate separation. Many of these mod-

ern concepts are, however, no more complete than older concepts in regard to the manner in which a separate Black economy can be operated and sustained.

*Black Panthers and Black Muslims.* The Black Muslims believe that the Western world is deteriorating, arguing that within it immorality is widespread. They feel that the only alternative open to the Black since he should not be integrated into a corrupt society, is to separate. The separate system would be one in which the life and liberty of the Black would not be controlled or regulated by non-Blacks. The economic element of this rejection of Western society is reflected in the criticism of capitalism as a tool for exploitation of the Black man. For example, Malcolm X, a former Black Muslim, and an early interpreter of some current Black Panther philosophy, noted in 1965 that

It is impossible for capitalism to survive, primarily because the system needs some blood to suck. Capitalism used to be like an eagle, but now it is more like a vulture. . . . As the nations of the world free themselves, then capitalism has less victims, less to suck, and it becomes weaker and weaker. It is only a matter of time in my opinion before it will collapse completely.<sup>7</sup>

The contemporary economic emphasis in the Black Panther organization is difficult to describe in detail. What is apparent, however, is that this organization wants "freedom" and the "power" to determine the destiny of the Black community. Other economic elements of their wants are decent housing, educational programs uniquely designed for Blacks, and full employment. They maintain that the government is responsible for this full employment plus a guaranteed annual income and that if full employment cannot be provided by the White business community, the means of production should be taken from the business men and placed in the community. The population of the community would then organize the business structure in such a way as to employ everyone in positions that assure a decent standard of living. Since White landlords do not provide decent housing, property should be expropriated and cooperatives set up with government help to provide acceptable standards of housing. The Black Panthers also ask for a cash indemnity from the government as "compensation" for the "genocide" of 50 million Blacks by "racist" America. The total sought is based upon a contention that forty acres and two mules were promised the Blacks as retribution for slavery and is an overdue debt.

The Panthers "reserve" the "right" to alter and abolish the system of

<sup>7</sup> From interview, *Young Socialist*, March-April, 1965; cited in *Malcolm X Speaks*, "Last Answers and Interviews."

government and institute a new form of government they say will be more consistent with the safety and happiness of indigenous peoples. It is assumed that military and other associated means could be used to overthrow the system.<sup>8</sup>

Related militant views on the relationship between Black economic power and Black political power were expressed in the publication *Black Power*.

In the final analysis, we prefer cooperative Black business ventures to private enterprise, . . . Finally within the Afroamerican's struggle for survival and national liberation, Black Business must be viewed as an aid to that struggle, and not an end in itself. There is no way to achieve liberation inside the framework of Chuck's economic system; we can achieve a certain degree of autonomy in the economic sphere, but in the final analysis, BLACK POLITICAL INDEPENDENCE MUST PRECEDE BLACK ECONOMIC INDEPENDENCE! BLACK POWER!<sup>9</sup>

The time span of implementation and the method of operating a separate Black economy are not detailed. Other than the reference to expropriation, and the cooperative movement, it may be assumed that a central government would be responsible for selected resource allocation decisions in the autonomous Black community. The revolutionary overthrow of the existing economic institutions is a unique emphasis of the Black Power group.

The Black Panthers' program seems to contain certain secular and substantive but no operational elements of the Black Muslim concepts for economic autonomy.

The need to establish a Black Muslim nation is predicated on a conglomerate of religious, social, racial and economic factors. The Muslims have adopted a non-revolutionary approach in the early stages of establishing Black economic autonomy. Through "normal" church channels of cash contributions, plus sales of equity ownership, the Muslims have established a Black restaurant and supermarket in Chicago. They continue to plan for the regular establishment of those services needed by the indigenous Black community. The time span for implementing the separate Black economy is not firm nor are the details of location, form of industrial organization, or the structure of the system clear. The Muslims have, from time to time, espoused the concept that several southern states should be set aside for their use and occupancy. The implication is that the economy would be basically agricultural, located in the United States,

<sup>8</sup> See the *Black Panther*, November 23, 1967, p. 7. (Published by the Black Panther organization in California.)

<sup>9</sup> "Black Business: Its Role in the Liberation Struggle," *Black Power*, March 1967, p. 10.

and probably reflect stages of growth similar to those described by Rostow.<sup>10</sup>

*The Republic of New Africa Movement.* In the spring of 1968 two hundred Black persons met in Detroit to organize the Republic of New Africa, a new nation within the United States with a separate government and its own elected officials. At this organizational meeting the delegates approved a Declaration of Independence which stated that the Black peoples of America were "forever free and independent of the jurisdiction of the United States."<sup>11</sup>

The reasoning behind the complete separation from the United States is clearly delineated.

We cannot exist side by side with White America, with her huge military, unless she changes. Therefore we will have to depend upon internationalism for protection. But so long as we remain citizens of the United States of America no foreign government will come to our aid or even introduce our case to the U.N.<sup>12</sup>

This new "republic" proposes to establish a provisional capital in the State of Mississippi governed by its president, Robert F. Williams. The first goal of the new "government" is to hold a "plebiscite" among the Negro population of the United States. The results of this poll will be presented to the United Nations in an effort to persuade this international body to establish a legal base for the State in accordance with international law.

The Republic of New Africa has also requested "reparation payments" and land from the United States government.

Reparations have never been paid to Black people for the admitted wrongs of slavery (or since slavery) inflicted upon our ancestors with the sanction of the United States Constitution. . . . The principle of reparations for national wrongs, as for personal wrongs, is well established in international law. The West German government, for instance, has paid \$850 million in equipment and credits in reparations to Israel for wrongs committed by the Nazis against the Jews of Europe. Demands for reparations, funnelled through a united Black power congress must include not only the demand for money and goods such as machinery, factories and laboratories, but a demand for land. And the land we want is the land where we are: Mississippi population 42% Black, Louisiana 32%, Alabama 30%, Georgia 29%, and South Carolina 35%.<sup>13</sup>

Other than the demand for "reparations," the Republic of New Africa

<sup>10</sup> W. W. Rostow, *Stages of Economic Growth* (Cambridge: Harvard University Press, 1960).

<sup>11</sup> David Llorens, "Black Separatism in Perspective," *Ebony*, 33 (October, 1968), p. 38.

<sup>12</sup> Richard B. Henry, Minister of Information of The Republic of New Africa, quoted in Llorens, *ibid.*, p. 95.

<sup>13</sup> *Ibid.*

movement appears to be mainly political in nature with little specification of the economic form or mode of the new State.

*The Core approach.* Another evolutionary, separatist movement is led by the Congress of Racial Equality.

The key idea . . . is the realization on the part of the present leadership of CORE that we are in fact two separate nations, two individual people. There are Black people and there are White people. . . . If you look at yourself as a separate people, then you can view yourself as a nation-like entity. There are historical parallels. There were a number of peoples who didn't have any land for years, but who viewed themselves as a nation. And the nation State might, of course, be in the future, but the nations could co-exist. . . . Black nationalism would be the motivating factor behind the economic development. . . .<sup>14</sup>

The time span for the CORE program is long or "at least equal to the number of years that one has been held back or one has been held in check and could not make any economic breakthrough."<sup>15</sup>

Although the evolutionary as opposed to revolutionary emphasis dominates the CORE programs, the sense of urgency to provide immediate relief to the Black is apparent. "Anytime you are in mortal danger, and we conceive ourselves to be in mortal danger, . . . the confrontation between Black and White is on in this country and can be an awesome kind of potentiality for us, and probably for the greater society too."<sup>16</sup>

Roy Innis, national director of CORE, added form and substance to the organization's position in testifying before the resolutions committee at the 1968 Republican National Convention.

Blacks must manage and control the institutions that service their areas, as it has always been for other interest groups. There is an essential need in such institutions as educational, health, social service, sanitation, protection, fire, housing, etc.

Large and densely populated Black areas, especially in urban centers must have a change in status. They must become political sub-divisions of the state, instead of sub-colonial appendages of the cities. They must become more autonomous of the existing urban centers. In short, Black people must be able to control basic societal instruments in the social, political, and economic areas.<sup>17</sup>

CORE's push for economic independence, at least in the short run, is directed toward the implementation of the CORE Development Corporation and the passage of the Community Self-Development Act and the Rural Development Incentive Act of 1968.

<sup>14</sup> Interview with Kermit Scott, project director, CORE, July, 1968, Columbus, Ohio.

<sup>15</sup> *Ibid.*

<sup>16</sup> *Ibid.*

<sup>17</sup> Statement, before the Subcommittee on Equal Opportunity in an Urban Society for the Resolutions Committee, Republican National Convention, Miami Beach, Florida, July 30, 1968, pp. 6-7.

The goal of the CORE development program is to establish the power to produce wealth for low income individuals by financing a second or ghetto economy in which ownership can be acquired by indigenous Black families. CORE has proposed that corporations join with them in partnership arrangements. The corporation would first determine plant locations and then establish industries in the ghetto. CORE would determine the space and plant requirements and negotiate a lease on the property with this partner firm. The corporation would then provide the capital for plant construction. Rental income paid to CORE by the corporation would be used to repay indebtedness and to return to the firm its initial capital contribution. CORE would eventually assume full ownership after the corporation's equity investment was retired. The CORE interests would be held in a Development Corporation which would be owned by ghetto residents whose incomes were below some specified minimum.

An alternate technique for economic development has also been proposed by CORE. The corporation would pay a portion of its wage bill through an equity sharing or bonus program which would eventually transfer the ownership of the firm to the community.

In 1968 a concept developed by CORE for establishing community self-development and rural development corporations was introduced in the House of Representatives. This legislation represents the first attempt by a major Black organization to initiate and develop federal participation of this type and magnitude. The Community Self-Development Act is an extensive package designed to attack all basic problem elements in low income communities. The purpose of the legislation is to establish a new institutional structure in communities so that the indigenous population can achieve economic development and the ownership of resources through their own efforts and under their own control.

The basic elements of the program are the Community Development Corporation and the Community Development Bank. The CDC would own and manage subsidiary business and conduct a range of social services. For practical purposes, the CDC has features of a modern conglomerate corporation and a charitable foundation. The CDC Banks would serve the same general functions as the existing National Land Bank Association and as a secondary liquidity financial institution similar to the Federal Home Loan Banks. Tax incentives for large corporations are also built into the program. The incentives are designed to spur large corporations to establish plants in the local community, train local people as managers and then pass ownership to the CDC. Other programs are designed to mobilize the talents and resources of the people left behind.

The programs would require \$1 billion funding in 1970 and additional private and public subscription of hundreds of millions of dollars.

The companion Rural Development Incentive Act of 1968 is designed to provide incentives for industries to establish job-producing industrial and commercial facilities in rural poverty areas through a system of tax rebates and incentives.

What is most significant about the CORE program is that it is the *only* well-formulated and carefully designed program for economic development advocated by the Black Militants. No other militant organization has gone as far as CORE in setting forth the operational aspects of the steps necessary to establish ghetto autonomy.

The Self-Development Act is the economic phase of the total drive for Black autonomy. Mr. Innis noted in his testimony in July 1968 that "The constitution of the United States of America, which is a national contract for this nation, was never meant for Black people. . . . The obvious solution then is a new social contract (constitution). This contract will redefine the relationship between Blacks and Whites."<sup>18</sup>

#### IV

##### The Black Power Elements of Development

JAMES BOGGS, a writer from Detroit, is currently working to develop the political elements of the establishment of a unique autonomous and separate Black community. His work on the writing and development of a new social contract will add to the substantive understanding of the structure required by independent Black communities. Boggs has written extensively on the subject of revolution, cybernetics, capitalism and Black Power. Insight into his approach on the development of the economic elements of the social contract can be obtained from the following commentary.

The organization for Black Power must concentrate on the issue of political power and refuse to redefine and explain away Black Power as Black everything except Black political power.' The development of technology in the United States has made it impossible for Blacks to achieve economic power in the U.S.A., by the old means of capitalist development. The ability of U.S. capitalists today to produce an abundance not only makes competition with them on an economic capitalistic basis absurd but has already brought the U.S.A. technologically to the threshold of society where each can have according to his needs. Thus Black political power, coming at this juncture in the economically advanced U.S.A., is the key not only to Black liberation but to the introduction of a new society to emancipate economically the masses of the people in general. For

<sup>18</sup> *Ibid.*, p. 6.

Black political power will have to decide on the kind of economy and the aims and directions of the economy for the people.<sup>19</sup>

Black political control inexorably tied to the concept of Black economic development is an accepted premise among many leaders of Black militants.

For the Reverend Albert Cleague Jr., the emergence of a well-defined philosophy on self-determination is significant.

Self-determination means seeking an escape from the powerlessness which is the basic problem in the Black community, both in the areas of economics and in the area of politics. In the area of economics, the escape from powerlessness is a struggle for Black Power. It has to do with securing economic control of Black ghetto communities. . . .

Essentially during the last year we have tried to change from the position of being completely powerless, economically. It's been really White businesses controlling Black ghetto life with no sense of accountability to the Black community, and no sense of participation by the Black community. The businesses, industry, anything that comes in, just set up in the community and exploit it and does whatever they like without any participation or accountability.<sup>20</sup>

In practical terms Cleague is moving toward a form of local political control over schools and other public services as well as over employment and control by Blacks of businesses in the ghetto areas. This well-defined pattern of action is merely a stage in the evolutionary process of political and economic control until the Blacks can be made more powerful economically. Cleague has also criticized the basic concepts of Black capitalism because "it just continues an exploitive pattern." The "co-operative economy" is looked upon as a logical and acceptable alternative to the structure of Black economies. Cleague noted "that there doesn't seem to be any other way to avoid the exploitation that is going to creep in just by the sheer preponderance of the control of the money. Even on the basis of the community corporation, it's the same thing." The cooperative economy would prevent the drain of economic power to selected groups, make inroads into the basic capital shortage problem, and permit the form of organization to be used in economic and non-economic activities to assure local control. In the development process it is assumed that Black cooperatives would first be substituted for existing retail and services outlays and then be extended to manufacturing, then back to the farm or agriculture and then through the entire economic system. Cleague knows and has made use of Sweden's experiments in cooperatives. The interest in that country's experience continues to be a source of knowledge and motivation for those Militants following Rev. Cleague. The cooperative

<sup>19</sup> James Boggs, "Black Power," *The Liberator*, May 1967, part II, p. 9.

<sup>20</sup> Interview with Rev. Cleague in Detroit, July 24, 1968, (Central United Church of Christ).

thrust is consistent with the militant concept that "Black people, more and more, recognize the fact that their identification with the total structure has been broken. Most Black people are willing to do the sacrificial thing necessary in order to help Black people to build some kind of economic position in American life."<sup>21</sup>

Support for this separatist approach among Black nationalists is based on new dimensions of being Black. For example, Rolland Snelling writing in the *Liberator* indicated that "... before we can free our people from White America, we must first free ourselves! This can be accomplished by what is called the Internal Revolution of the psyche. We must search ourselves through and through to thoroughly examine our outlooks and goals, comparing them with the realities of present-day White America with its technical barbarism which is strangling our race." Snelling is an outspoken critic of capitalism, Black or White. The economic and its related political system he holds, perpetuate a system of exploitation through a master and slave relationship.<sup>22</sup>

Daniel Watts, the editor of the *Liberator*, a Black militant monthly, eloquently phrases the Black dilemma:

... "do we want to save America, is America worth saving?" It seems to me that this is the fundamental question, given the violent nature of American society today, the apparently increasing emphasis on violence as a way of life and this impenetrable wall of hate that emanates from the White community. I think one of the fundamental questions that the Black people must answer is "do we want in?" I think this leads to a great deal of confusion in the Black community. So despite the fact that you have many militants screaming "Black Power" and talking about the economic viability of the Black community and things like that, there is still a great deal of ambivalence among ourselves as to whether or not we want in the American scene. So let's assume for purposes of this discussion that we want into the American scene, into the mainstream of America.

It seems to me that our interest in the mainstream would mean a fundamental change in the economic, political, and social structure of America... we have to constitutionally find a way in which the races can co-exist together.... If there is any tacit admission that the Black people have a right to live in this world, there we may have the basis for a new social, political, and economic order in this country.<sup>23</sup>

Despite the fact that Watts illustrates the dilemma and points the way to the embryonic steps of accommodation between the separatists and the moderates, he believes that Whites with economic and political power will

<sup>21</sup> *Ibid.*

<sup>22</sup> Rolland Snelling, "Toward Repudiating Western Values," *Liberator*, November, 1964, pp. 11-12.

<sup>23</sup> Interview with Mr. Daniel Watts in New York City, July 18, 1968.

not give up that power. The issue for Watts is whether or not the White community is willing to sit down with Black leaders and discuss the meaningful transference and sharing of power and co-existence. If the Whites do not, "we are going to have to fight White America at the barricades."<sup>24</sup>

Given the attitudes concerning the alternatives faced by the Blacks in gaining some limited degree of economic development, it is important to note that the bases for a separate economy and political system are fairly well-established in the ethos of the Black-White confrontations. The political elements of the separatist concept are intertwined with the economic aspects. The separate political and economic entity concept have been illustrated here without reference to the actual viability of separate Black nations or economies. Regardless of the validity of the thesis of viability of Black autonomies, widespread evidence exists that able Black leadership would prefer to "make it" economically outside the system, and represent one polar case strategy to improve the economic conditions of the Black.

## V

### **The Issues—Summary and Conclusions**

THE DICHOTOMY CONFRONTING the American Negro has been whether to attempt to achieve meaningful integration into a social and institutional structure resistant to this effort, or to separate from the society, and thus from the controls and the constraints exercised through its institutions. Because of exhaustion of other alternatives than the economic and because of the evolving nature of the movement for equal rights, present activities of that movement must focus upon problems of economic advancement of the Negro within the Black community. This ideological dilemma in the choice of effective action is now transferred into an economic context.

Within this context militant leaders of national organizations have bypassed the historical emphasis of civil rights organizations on attempting to achieve economic integration through jobs and skills training. They argue that economic development for the Negro can only come through Black ownership and Black control of productive resources. The tactical dilemma facing the Negro is whether to attempt to build viable Black economic institutions within the existing and largely White economic structure, or to establish these institutions within a separate, all-Black environment. The militants have resolved this tactical dilemma in favor of separation.

Within the separate Black economy alternative, another choice of strat-

<sup>24</sup> Watts interview, July 18, 1968.

egy has yet to be made. One option is a semi-separate State in which economic institutions would be established in the racial ghettos of the cities. Another option would be the establishment of a geographically separate State with no political ties with the existing national structure.

This paper has surveyed and briefly catalogued the alternatives advocated by militant leaders of national organizations and the techniques for implementing these goals. It is not feasible in this paper to give a careful evaluation of these programs. But the correspondence between the development alternatives currently advocated by militants and pervasive social policies may be assessed. The report of the National Advisory Commission on Civil Disorders concluded that three basic future choices confront the United States in the attempt to provide socially viable answers to the problems of our cities. Under the first alternative, the "present policies choice," the share of national resources presently allocated to welfare efforts would be maintained. The absolute amount of welfare allocations should increase through time with the growth of federal revenues. Since the present share of federal revenues allocated to anti-poverty programs is insufficient even to carry out a holding action against the social and economic deterioration of the inner-city, the Commission argues that the "present policies choice" is not a realistic solution.

The second alternative, "the enrichment choice," would attempt to offset the adverse effects of continued segregation and deprivation of the ghetto, and generate significant improvements in the environmental quality of these areas. This effort would not be designed to affect appreciably the pattern of segregation in the inner-city, but make the ghetto areas more habitable.

The third alternative, "the integration choice," would improve the quality of life in racial enclaves, but with the concomitant emphasis of creating incentives for out-migration from inner-city ghettos, and integration into the social, economic, and political fabric of American life.

The integration alternative under which every citizen can exercise free choice without confronting racial barriers corresponds most closely to the idealism which American social philosophy has historically expressed. But it is now evident that economic programs are formulated in government agencies, in industry, and in the Black community, without consideration of their long-run social consequences, and which may lead inadvertently to the "enrichment choice." For example, the present emphasis on ghetto economic development and Black capitalism implies that the ghetto can serve as a viable unit for economic development. Attempts are being made to bring industry into the inner-city to provide sources of income for

ghetto residents, and to make available capital funds to assist Negro entrepreneurs in establishing Black businesses which cater to a market composed of Negro consumers. Policies of this nature may result in increasing rigidity of the segregated pattern of life in metropolitan areas.

The crucial decision to be made in the Black community is whether the "integration choice" is feasible and desirable at the economic level. In terms of productive capacity and the potential to provide an acceptable level of economic welfare for all members of the society, the capitalistic system is worth attempting to integrate. Daniel Watts, a militant, has recognized this.

Which now leads us to the whole question of whether Black people accept capitalism. This question was asked of me at a university by one of the White students who took the position that capitalism was intrinsically bad, it was exploitive, etc., etc. I take the position that we, the Black community, would bring a new dimension in terms of human wealth, human values into the White capitalist system in terms of how we view human life and the value that we place on it as opposed to the Whites who, I think, look upon human life as something secondary, something to be bargained for with dollars. I don't think that coming out of the Black experience that Black people would view human beings in the same light as Whites do. So I think that it is still possible for Black people to get involved in the capitalistic structure, and whether you like it or not, the basic fact of life is that the capitalistic system in America does produce. There is no question about it, the system works, it produces.<sup>25</sup>

If, however, it is true that elements of racial constraint are built into all American institutions, it may not be possible to achieve economic integration into our capitalistic system as presently constituted. The Reverend Albert Cleague, militantly argues that this is the case.

... I think as far as the Black community is concerned, the capitalistic economy doesn't work for us because we don't have any stake in it. It just happens that when we got to a place where we were able to do something, we were outside and the concentration of wealth in the White capitalistic set up is so complete now that you can't break into that. And with all the other racist elements in American society, we are not only outside of it, but we are frozen outside of it.<sup>26, 27</sup>

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<sup>25</sup> Interview with Mr. Daniel Watts in New York City, July 18, 1968.

<sup>26</sup> Reverend Albert Cleague, personal interview in Detroit, July 24, 1968, Central United Church of Christ.

<sup>27</sup> The moderate approaches, which are based on a different view, are discussed in a subsequent paper.

### *The Rights of the Child*

ELEVEN YEARS AGO, the United Nations adopted the "Declaration of the Rights of the Child," proclaiming that "mankind owes to the child the best it has to give." The gap between the ideals of that Declaration and the grim facts reported recently by Secretary-General U Thant reflects a problem that is running away from those striving to cope with it. Much more must be done.

Consider the sheer magnitude of the problem. In the less developed regions of the world the number of children under 15 increased by about 257 million during the last eleven years, to the present total of some 1,052 million. In most developing countries, they comprise more than 40 per cent of the population; in some, over half. And through the decade of the 1970's their numbers are expected to increase another 270 million. In the more developed countries, the child population of the same age has grown only some 13 million in the past decade, and is expected to increase another 20 million during the 70's.

The question of quality also arises. As one expert on development has put it: If we believe—as we do now—that the incidence of genius is equally distributed throughout the world, then for every Einstein produced by the developed countries, there are four other potential Einsteins in the underdeveloped regions who never get a chance to emerge—whose genius is lost to us all.

That is why UNICEF's concern has turned increasingly to the need to develop children, to give them an opportunity to realize their full growth, as it is an essential factor in the development of their countries. The children are each nation's greatest natural resource. Given a chance, they will contribute to its growth as productive, creative, energetic adults.

Their needs have become so pressing that UNICEF has begun "noting" long-range projects for children it would like to help beyond the limits of its current income—and some governments and private organizations are responding to the need with special contributions. [From the U.S. Committee for UNICEF.]

### *New Journal in Turkey*

HACETTEPE UNIVERSITY in Ankara, Turkey, established in 1969 a semi-annual journal, the *Hacettepe Bulletin of Social Sciences and Humanities* for reports on research in the indicated areas. The articles are largely in English but occasional authors may use other European languages. Thus the new journal will be a means of communication between Turkish scholars at home and abroad and their non-Turkish colleagues. The annual subscription is US\$1.50 and the address is Hacettepe Universitesi, Basim Ve Yayim Merkezi, Ankara, Turkey.

## Methodological Problems in Contrasting Economic Systems\*

By HORST K. BETZ and E. K. HUNT

THE MAJOR PROBLEM ORIENTATION of this paper is to point out some of the methodological deficiencies exhibited by the current literature on comparative economic systems to which students at present are exposed. This literature is characterized by a dominant tendency to organize the analysis in traditional neo-classical economic categories, to use the analytical tools of neo-classical economics and to rely heavily on its normative criterion of efficiency or one of its corollaries in evaluating the economic performance of competing systems. We hope to show that the criterion of market efficiency is of dubious value in a conventional analysis of economic policy and worthless as a means of comparing economic systems. Further, conventional economic analysis by abstracting the economic subsystem from the total cultural system has often resulted in a "misplaced concreteness" which causes many investigators to ignore completely social institutions which are the sine qua non of the total cultural complex of which the economic subsystem is part. For this and other reasons we believe that a type of interdisciplinary structural-functional approach represents the best means by which the understanding of competing economic systems can be furthered.

The structural-functional approach is not, of course, new in the social sciences in general or even economics in particular. Our contribution here will represent an attempt to demonstrate the applicability of this approach to the analysis of comparative economic systems, a field, we feel, where this approach has its greatest potential.

### I

W. STARK HAS WRITTEN that "viewed historically . . . political economy is the investigation and analysis of the order dominant in [the] modern exchange economy."<sup>1</sup> If this is so the economist qua orthodox economist can have little to say about a centrally planned socialist economy.

However, many economists—particularly those in the Lausanne tradition—would probably reject this definition and insist that most of the deductions of economics are based on two concepts which they believe to

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<sup>1</sup> W. Stark: *The History of Economics* (London: Kegan Paul, Trench, Truber & Co., 1944), p. 61.

be universal and timeless: scarcity and the choice between alternative uses of scarce means.

The Lausanne formulation has a superficial plausibility: men are, and have always been, confronted with a scarcity of provision; choices must be made regarding alternative uses of scarce resources. However, it is obvious that men have reacted to this same situation in completely different ways under different social systems. It is equally obvious that the friction of the "economic man" of orthodox economics has descriptive value only as it relates to certain features of the man who is the product of market capitalism. "Even the famous Robinson Crusoe is only the man of modern [capitalism] in isolation, not some isolated man—such a one cannot exist, and least of all as a being capable of reasonable choice."<sup>2</sup>

Thus the economic theory of rational maximization which forms the foundation of the largest part of "pure theory" in economics is descriptive only in a very narrow and imperfect way. It includes a set of characteristics which more or less adequately describe and explain some situations in a market capitalist society.

It is more fundamentally a normative theory. Joan Robinson calls it an "ideology to end ideologies,"<sup>3</sup> and S. S. Alexander notes that it "grants *our* social institutions immunity from criticism other than on the grounds of efficiency."<sup>4</sup>

It would make an interesting problem in the sociology of knowledge to attempt to understand the extent to which economists during the last several decades have accepted two contradictory premises: that economics is potentially and ought to be a *wertfrei* science and that the criterion of market efficiency is and ought to be universally accepted as scientific.

"The economist's value judgments," writes Milton Friedman, "doubtless influence the subject he works on and perhaps at times the conclusions he reaches. . . . Yet this does not alter the fundamental point that, in principle, there are no value judgments [in economics]."<sup>5</sup>

If Friedman's assertion were true then a course in comparative economic systems would be reduced to a collection of positivistic assertions and descriptions of different economies which would presumably be followed by a series of emotive statements reflecting the unscientific biases of the instructor. In our survey of the texts in the field we found none that were willing to treat the subject in this manner. The textbooks show the

<sup>2</sup> *Ibid.*, p. 62.

<sup>3</sup> Joan Robinson, *Economic Philosophy* (Garden City: Doubleday, Anchor Books, 1964), p. 64.

<sup>4</sup> S. S. Alexander, "Human Values and Economists' Values" in *Human Values and Economic Policy*, ed. S. Hook (New York: New York University Press, 1967), p. 111.

<sup>5</sup> Milton Friedman, "Value Judgments in Economics" in Hook *op. cit.*, p. 86.

extent to which the criterion of efficiency and various corollaries of this criterion are almost universally accepted as scientifically valid normative criteria by which to compare competing economic systems.

The criterion of efficiency is based on the norm of Paretean Optimality. In its original form and for many decades it was framed in terms of utility. But the notion of diminishing marginal utility had uncomfortably radical egalitarian implications. According to Robinson, "the method by which the egalitarian element in the doctrine was sterilized was mainly by slipping from utility to physical output as the object to be maximized."<sup>6</sup>

Thus the criteria of full employment, growth, economic stability and a technologically progressive economy all reduce to a rather expanded version of the criterion of efficiency which Alexander calls the "pig principle." The pig principle states "that if you like something, more is better."<sup>7</sup>

It is obvious that on a social level the pig principle can only be defended on the assumption that the structure of relative prices embodies the ultimate moral principle upon which normal judgments are based. It was in recognition of this fact that the Austrian school laid so much emphasis on the notion of a "rational price structure." For them the statement that the capitalist market system created a rational price structure was tantamount to giving the pig principle its place as the foundation of all social and moral judgments. The rationality of the price system supposedly derived from its reflection of the relative strengths of the desires of the persons within the social system (ignoring the equity problem).

The theory of market rationality is open to criticism on two levels. On the technical level if the theory is modified to take into account the interrelationships involved in production and consumption it exhibits logical difficulties at every turn.<sup>8</sup> A more fundamental weakness from a normative standpoint is that these desires which gave the price system its rationality are themselves treated as ultimate, metaphysically immutable givens, each on an equal footing with the other. The underlying theory of action for the possessors of these desires was described by Veblen:

[This] conception of man is that of a lightning calculator of pleasures and pains, who oscillates like a homogeneous globule of desire of happiness under the impulse of stimuli that shift him about the area, but leave him intact. He has neither antecedent nor consequent. He is an isolated definitive human datum, in stable equilibrium except for the buffets of the impinging forces that displace him in one direction or another. Self-imposed in elemental space, he spins symmetrically about his own spiritual

<sup>6</sup> Robinson, *op. cit.*, p. 56.

<sup>7</sup> Alexander, *op. cit.*, p. 107.

<sup>8</sup> See e.g. E. K. Hunt, "Orthodox Economic Theory and Capitalist Ideology," *Monthly Review*, Vol. 19, No. 9 (Feb., 1968), pp. 50-55.

axis until the parallelogram of forces bears down upon him, whereupon he follows the line of the resultant. When the force of the impact is spent, he comes to rest, a self-contained globule of desire as before.<sup>9</sup>

Thus the neoclassical theory upon which the criterion of efficiency is based completely ignores the social institutions which to a large extent determine the types of wants and desires the individuals in a given social system will have and the ways in which they will attempt to satisfy these desires. The desires are simply taken as the metaphysically given criteria of goodness and badness.

Economists have usually been somewhat uncomfortable with this patently untenable version of human nature as can be seen in Adam Smith's treatment of "moral sentiments," Ricardo's "habits and customs of the people," and Marshall's "wants adjusted to activities." However, when it comes to a defense of the rationality of the market price structure and the normative criterion of market efficiency these sociological after-thoughts have absolutely no place.

Market efficiency despite its superficial plausibility as an impartial normative criterion shows itself on examination to be virtually worthless. In the words of Joan Robinson, "... drug fiends should be cured; children should go to school. How do we decide which preferences should be respected and what restrained unless we judge the preferences themselves."<sup>10</sup> Indeed, the present writers agree with de Graaff that "the measure of acceptance . . . [this theory] has won among professional economists would be astonishing were not its pedigree so long and respectable."<sup>11</sup>

If, as many social scientists believe, the market and its many attendant economic, social and political institutions influence the entire fabric of our society then the traditional handling of externalities in economics is completely inadequate. Externalities, of course, refer to the ways that market transactions affect those who are not directly involved in the transactions. Externalities have been handled traditionally within the context of Paretean optimality. What traditional economics has ignored is the fact that the very nature of the social process itself can in fact be considered an externality.

If a social process creates desires in the majority of the participants in that process which when subjected to some normative criteria are repugnant to different persons from different societies, it makes absolutely no

<sup>9</sup> *The Portable Veblen*, ed. Max Lerner, (New York: The Viking Press, 1948), pp. 232-33.

<sup>10</sup> Robinson, *op. cit.*, p. 50.

<sup>11</sup> J. DeV. Graaff, *Theoretical Welfare Economics* (Cambridge, Eng.: Cambridge University Press, 1957), p. 142.

sense to ask our participants if they would prefer having different preference patterns and how much they would be willing to pay for these new preference patterns. In the words of S. S. Alexander:

The pig will not want to pay anything to be made into a Socrates.

That wants are generated by the social process . . . in the profound sense of the dependence on the whole cultural matrix certainly threatens the entire ethical basis of [traditional] economics, striking in particular at Pareto optimality. *It challenges the principle that more is better and opens up the question of what sort of wants we should generate, what sort of men we should make.*<sup>12</sup>

It is obvious that the criterion of market efficiency involves a sort of ego-centric myopia of which one should be wary in any serious discussion of normative economics. It is even more obvious that this approach is worse than meaningless and useless when attempting to compare and evaluate totally different social and economic systems. Such an undertaking requires not only an explicit, normative model of the Good Society and the Good Man but also entails the necessity of attempting an evaluation of any and all important social and cultural institutions and their relationships to the whole social system. Economic systems must be seen as integral parts of whole historically evolving social systems, separable in the economists' analytical model only at the cost of a considerable distortion of reality.

It is our belief that a separation has been made in orthodox economic analysis. Whether explicitly or implicitly, conventional economic theory has made what can be called an autonomy claim for the economic subsystem within the total social system. This results in what Whitehead has called the "fallacy of misplaced concreteness."

Whenever an analysis based on the isolation of economic phenomena is undertaken the burden of proof is with the investigator to demonstrate the scientific soundness as well as empirical meaningfulness and relevance of relegating all non-economic factors to parameters of the system. This challenge, however, is seldom acknowledged and even less frequently met.

The treatment of what are considered purely economic aspects as a closed system results in very serious ontological problems. As a matter of fact, the social character of all central economic problem formulations renders the autonomy claim of economic theory useful only if the latter is considered a pure logic of choice in the very narrowest sense. To paraphrase Parsons, empiricist reification of theoretical systems has to be replaced by an analytical realism.<sup>13</sup> This is absolutely necessary to achieve

<sup>12</sup> Alexander, *op. cit.*, p. 110. Italics added.

<sup>13</sup> Talcott Parsons, *The Structure of Social Action* (Glencoe, Ill.: The Free Press, 1949), p. 757.

empirically relevant and meaningful results especially if the express purpose of analysis is to explain and evaluate, rather than merely describe, comparative economic systems.

With few exceptions only such eminent German scholars as Werner Sombart and Max Weber (to some extent under the influence of Marx) have made an attempt to integrate the study of economic activities into the broader framework of social and economic systems. They, of course, were writing in a country which, given its cultural and intellectual heritage, remained out of the mainstream of orthodox economic theory and its concomitant assumptions of utilitarian individualism. In the light of the path the development of our discipline has taken in recent decades a meaningful synthesis of methods, especially as applicable to the study of economic systems, has been prevented. Schumpeter, on one occasion (the review of the third volume of Sombart's *Der moderne Kapitalismus*), exclaimed: "Yes—if one could only combine Sombart and Edgeworth."<sup>14</sup>

When economics is integrated into this broader framework it becomes obvious that neither individual nor social values can be taken as given. Under these circumstances the notion of efficiency has no meaning until the bases of social values are comprehended. For example, to postulate a maximum production of goods and services certainly reflects an ideological position totally different from one for which these same economic activities are subordinated to the aim of securing a political optimum. It should then go without saying that we cannot make use of the valuative criteria of one to judge the "efficiency" of the other.<sup>15</sup> We would also do well to heed the advice Joan Robinson offers in concluding her challenging and, undoubtedly, controversial book, namely to combat the "ideology which pretends that values which can be measured in terms of money are the only ones that ought to count."<sup>16</sup>

## II

IMPLICIT IN THE PRECEDING DISCUSSION was a plea which, at this point, should be made explicit. Even a cursory look at the literature on comparative economic systems to which students are exposed reveals the pressing need for a greater degree of interdisciplinary research in the field. Strangely enough, this need has been recognized in some of the other newer areas such as transportation and urban problems but not to the same degree in the much broader and still more complex field of comparative

<sup>14</sup> Joseph Schumpeter, "Sombarts Dritter Band," *Schmollers Jahrbuch*, Vol. 51 (June, 1927), p. 6.

<sup>15</sup> On the problem of the admissibility of value judgments see below.

<sup>16</sup> Joan Robinson, *op. cit.*, p. 147.

economic systems, which, of course, is a relatively new area of concentration as well. Undoubtedly the above-discussed autonomy claim of economic theory, which has prevented an operationally meaningful synthesis of methods, is at least partly responsible for this plight. Also, the apparently higher payoff for greatly specialized work within each of the various social sciences has almost totally blocked a theoretically integrated attack on the totality of society and has led instead to an increasing compartmentalization of research with, at times, rather questionable empirical relevance.

Investigators in the various social sciences simply cannot afford to ignore the type of work in which their colleagues in other, related disciplines are engaged. What we must be able to afford to ignore, on the other hand, are some of the artificially established and, at times, arbitrarily defined boundary lines between the different social sciences and even some of the humanities. We have to recognize that economic actions are only intermediate means directed toward intermediate ends which, in turn, become means oriented toward the "ultimate" ends of the social and cultural system as a whole. It is for this reason that interdisciplinary research is increasingly needed in order to eliminate or, at least, realize and control the type of biased observation and evaluation which at present has been created by the very overspecialization in the social sciences. These methodological difficulties will not be overcome as long as the scant dialogue, and even alienation, between disciplines exists. And this problem seems to be nowhere as severe as in the field of comparative economic systems. A concrete illustration of this, by means of scrutinizing the validity of the so-called "convergence thesis," will be provided below. For instance, the non-economic implications of the process of "economic" reforms can only be comprehended if we look at those aspects which are usually treated as parameters for the interactions of purely economic variables.

It is imperative, then, that any potentially successful analysis, explanation and evaluation of contrasting economic systems must draw on the tools of analysis provided by such related disciplines as political science, sociology, history and philosophy. Economic systems must be treated as historical categories in as much as they are the combined result of ideologies, institutions, traditions, technological development and physical environment.<sup>17</sup> Certainly the common treatment of economic systems as

<sup>17</sup> Karl Polanyi, *The Great Transformation* (New York: Oxford University Press, 1944), p. 10. Polanyi also points out that the concept of "economic system" is a historical category, and that it is not possible to consider an economic system as a state in the process of social development at which certain "factors" are dominant. He also points out that the concept of "economic system" is a historical category, and that it is not possible to consider an economic system as a state in the process of social development at which certain "factors" are dominant. (Polanyi, *Sociale Theorie der Wirtschaftssysteme* (Ludwig, Germany: J. C. B. Mohr, 1944), p. 10.)

sources among alternative ends does not carry us very far. This much too narrowly conceived definition leads only to a purely operational-descriptive presentation. True, there is the occasional attempt at evaluation yet this is usually based upon but poorly-concealed or subconscious biases of the type discussed above.<sup>18</sup>

The very fact that each social structure, as has been argued at length above, has elements of social, political and economic importance as well as being rooted in the past makes it possible to take even as general a statement as the following for a more meaningful starting point when contrasting systems: "An economic system requires a set of rules, an ideology to justify them, and a conscience in the individual which makes him strive to carry them out."<sup>19</sup> It certainly goes beyond the commonplace explanations offered, namely that contrasting economic systems differ mainly in terms of their economic organizations and institutions and it then becomes the main task for the investigator to proceed in elaborate descriptions of what these differences actually are. No attempt whatsoever is made to tackle the crucial question of why these systems really are different. It is the inadmissibility of value judgments which, so goes the argument, keeps us from trying to find an answer to this question. Curiously enough, however, this professed adherence to strictly positivist analysis has not prevented these writers from imposing the performance criteria of our system on whichever ones are analysed; and, furthermore, it suggests a certain degree of unfamiliarity with the problem of the admissibility of value judgments into the realm of scientific investigation.

While it is beyond the scope of this paper to develop a full-fledged methodology of economic systems (our task is rather to concentrate on and point out the theoretical and methodological difficulties of presently prevailing approaches), we nevertheless do feel obligated to indicate at least a tentative outline of the directions further research should take.

For the purpose of analyzing, explaining as well as evaluating contrasting economic systems we propose to adopt a modified structural-functional approach as pioneered largely by sociologists. While we are fully aware of the shortcomings of this approach as well as the criticism levelled against it, we are convinced that the opportunity cost involved in con-

<sup>18</sup> There is also, for instance, the occasional discussion of Marx's theory of history and labor theory of value which, the respective authors seem to feel, constitute necessary ingredients without, however, at the same time being able to answer the question: "Necessary for what?" The material is left completely unconnected. The impression here is that there seems to be considerable doubt as to the box into which it properly belongs: capitalism, socialism, communism or any particular aspects of these?

<sup>19</sup> Robinson, *op. cit.*, p. 13. Even Sombart's pioneering triad of ethos, order and technology of an economic system facilitates an investigation of the economic relevance of non-economic phenomena.

tinuing to pursue the prevailing line of investigation is simply too high.

The advantages, for our purposes, of approaching the study of economic systems from a structural-functional point of view is that it unfolds before us the social and cultural system as a whole and thereby provides a setting which enables us to identify the significant relationships between the relevant variables. The necessary starting point for this particular scheme of analysis must be the normative order of the system, *i.e.* the common system of value and belief patterns. Since economic systems, as part of a more comprehensive social entity, are, after all, essentially man-made, they are inherently prescriptive. It is the pattern of common values which provides a sense of unity for the system and, concomitantly, the necessary incentives for its members to commit themselves and act accordingly. It should be inconceivable to analyze an economic system on the basis of a conceptual separation of its operational and institutional aspects from its normative order. Such a methodological procedure would relegate the concept of an economic system onto Clapham's well-known shelf of empty boxes. It is in this area that an arbitrary separation of economics from ethics is not possible other than at uncomfortably high costs. Therefore, it is imperative that the normative postulates of an economic system be identified in order to understand<sup>20</sup> and interpret the system.

This common pattern of beliefs and values constitutes the cultural system which, in turn, specifies the goals and acceptable means for the social system by establishing ideals as well as conditioning the latter's constituent elements to adhere to its (the cultural system's) prescriptions. It is only in these terms that certain actions can be termed rational or irrational. The normative order, then, refers to what Dahl and Lindblom in their *Politics, Economics and Welfare* have called "social indoctrination" which provides the basis for a stable organizational-structural system of social control and its requirements can be considered a necessary condition in order to establish a consistent pattern of praxiological rules conducive to rational action (in terms of socially postulated goals) before the specifically economic control techniques required can be identified and, subsequently, established. Starting with the process of social control "is to begin a long way from prices, markets, corporations . . . and the other institutions of politico-economic life."<sup>21</sup> Economic processes per se do not become relevant for analytical purposes until the social control process, in the form of institutions, has defined the acceptable ends (goal-orient-

<sup>20</sup> We chose to use the English word here instead of the somewhat unjustifiably methodologically discredited German term *verstehen*.

<sup>21</sup> Robert A. Dahl and Charles E. Lindblom, *Politics, Economics and Welfare* (New York: Harper Torchbooks, 1963), p. 22.

tation) and legitimized or sanctioned the permissible means.<sup>22</sup> Consequently, the means and ends directly governing economic conditions are of an intermediate nature, and the further removed from the ultimate ends they are the more morally neutral they appear and "will obviously reduce the number of elements of the situation confronting the actor which from his point of view are means rather than conditions."<sup>23</sup> In the process of establishing the intermediate goals, that is, for our purposes, in conditioning purely economic actions the reward system (monetary as well as non-monetary) is of highly symbolic significance.

In this connection a special problem needs to be discussed briefly. A commonly committed mistake in the treatment of comparative economic systems is the assumption of an ideologically neutral technology. The following arguments, we feel, should adequately dispel this notion. First of all, let us look at the particular case of the Soviet Union. Both the technological neglect of agriculture as well as the hesitancy in the introduction of computers certainly were ideologically conditioned. A similar argument can be made with regard to the long prevailing lack of initiative for technological progress in the consumer goods sector. Secondly, and more generally, technological progress, causing an ever more intricate division of labor, requires increasingly more elaborate organizational arrangements. The nature of these arrangements certainly is not ideologically neutral. And finally, rapid technological advance does create economic, social and political problems. Their solution then becomes part of the task of the social control process which, as was argued above, represents nothing but an institutionalization of the normative order.

Coming back, however, to the role of the economy within the social system, we feel that the former must be treated as a functional subsystem of the latter with which it "exchanges inputs and outputs over its boundaries." Therefore, the influence of and conditioning by non-economic variables must not be neglected. "At the very least . . . analysis of concrete economic processes always must rest on non-economic assumptions."<sup>24</sup> There are a significant number of commonly considered economic processes which in fact operate at boundaries with other segments

<sup>22</sup> This requires a minimum degree of consistency and stability of those value patterns which have become institutionalized in this form. Should certain elements within the social system become too independent relative to these institutionalized value patterns a more forceful regulative functional pattern is required if stability is to be maintained. As a case in point the treatment of restless intellectuals in the Soviet Union might be mentioned; or in the wider context of the Soviet bloc as a whole, the pressure exerted on liberalizing Czechoslovakia.

<sup>23</sup> Andreas G. Papandreou, "Economics and the Social Sciences," *Economic Journal*, Vol. 60 (1959), p. 723.

<sup>24</sup> Talcott Parsons and Neil Smelser, *Economy and Society* (Glencoe, Ill.: The Free Press, 1956), p. 307.

of the social and cultural systems, such as the transition from production to consumption or the determination of the share of society's resources of a physical, human, financial and cultural nature allocated to the economy.<sup>25</sup> While such economic categories as factory or farm as parts of the economic subsystem lend themselves quite readily to a descriptively-oriented investigation, to place these categories into an empirically more relevant framework we have to inquire how they are fitted and integrated in the social system as a whole. How are these factories controlled and why? What roles do their executive play? What is the purpose of setting agricultural procurement prices at one level rather than another? These are the type of questions which should be asked and determine the direction of problem-orientation. Especially if we are interested in evaluating and assessing an economy's performance we first have to answer the question of why does an economy operate the way it does; and for this we have to look for the functional relationships between the economy and the whole of the socio-cultural complex.

### III

IS IT THEN POSSIBLE to evaluate the performance of an economic system objectively? We would tend to answer this query in the affirmative as soon as the normative order, which controls the economy as a functional subsystem of the total social system, has been identified and made explicit. It facilitates the determination of why certain choices rather than others are decided upon and whether or not they are conducive to the system in question. Only in this context, for example, does the concept of rationality assume meaningfulness. Thus economic rationality, in this sense, implies a conditioning of economic actions in terms of its prescribed goals. "The meaning of rationality is therefore limited to the orientation of action toward maximal conformity with a norm."<sup>26</sup> A number of controversies in the social sciences, especially as it pertains to the problem of rationality, are due to the making of elliptical judgments on the respective rationality or irrationality of certain actions without defining the term itself or, if it is done, in terms of inapplicable praxiological rules. "To agree whether one action is more rational than another, observers must agree on the goals involved, their assumptions about reality, and the consequence for goal achievement of certain alternative courses of action given the assumed reality."<sup>27</sup>

An objective evaluation of economic as well as other actions, after the

<sup>25</sup> *Ibid.*, pp. 22-24.

<sup>26</sup> *Ibid.*, p. 176.

<sup>27</sup> Dahl and Lindblom, *op. cit.*, p. 20.

functional prescriptions and requirements for these actions have been established, should certainly become part of scientific analysis as long as we do not (even tacitly) impose an inadmissible type of prescription, such as the performance criteria of another system. While this appears to be a fairly straightforward methodological proposition it is, nevertheless, surprising how frequently it is contravened by allegedly "unbiased" analysis. "There is a fundamental test," one writer concludes, "by which it is possible to evaluate economic systems. That test is the extent to which different economic subjects, individuals and social entities, are permitted to make their own decisions concerning their own ends and the choice of corresponding means. The greater this possibility and the greater the numerical spread of economic subjects who can benefit by it the better the economic system will perform its function."<sup>28</sup>

It is quite common in the process of investigating comparative economic systems to at least tacitly make what may be considered inadmissible value judgments while at the same time openly disavowing the validity of any value judgments because they lie beyond the realm of scientific analysis. This attitude towards value judgments seems to arise out of some methodological uneasiness due to a lack of sufficient familiarity of a subject matter which under strong positivist influence has been placed beyond the boundaries of strictly economic analysis. We do feel, however, that value judgments can occupy a place in scientific analysis if they are properly put in terms of a relevant presupposed system of axiological rules. As Felix Kaufmann has pointed out: "[Most] value judgments are analytical propositions. The erroneous view that they are synthetic propositions has its roots in the elliptical formulation of value judgments and value problems."<sup>29</sup> To provide a complete in place of an elliptical formulation requires, he believes, "(a) to prove that certain valuations are warranted in terms of given axiological rules by virtue of established facts; and (b) to justify these rules in terms of presupposed rules of higher order [i.e. ultimate ends]."<sup>30</sup> Kaufmann here is largely arguing against such German scholars as Sombart and Weber who, on the occasion of the famous 1909 Vienna meeting of the *Verein für Sozialpolitik*, made their eloquent plea for *Wertfreiheit* in the social sciences. As Sombart put it at the time "no plummet of scientific inquiry can reach the depths of *Weltanschauung*."

In evaluating contrasting economic systems we need to test the consis-

<sup>28</sup> Cyril Zebot, "Evaluation of Economic System," *Review of Social Economy*, Vol. 7 (September, 1959), p. 61.

<sup>29</sup> Felix Kaufmann, *Methodology of the Social Sciences* (New York: Oxford University Press, 1944), p. 137.

<sup>30</sup> *Ibid.*, p. 205.

tency among the economic factors as well as between the economic and non-economic aspects of the social system as a whole. It is in this context that value judgments have to be made. Apart from addressing ourselves to the general problem of overall logical consistency we should also investigate and assess not the normative order as such but the means employed and how well they serve their purpose. Such judgments, given of course, the above-indicated necessary conditions of agreement on facts as well as a complete formulation of the problem in terms of the proper axiological rules, may as part of scientific analysis properly concern themselves with such problems of which we indicate only a few. For example, ontological judgments can be rendered in determining which existential principles of the social order may not be contravened. We may also ascertain whether or not certain actions or programs for action are based on an unrealistic appraisal or even misconception of realities.<sup>31</sup> And, as a final illustration, we might want to test how conducive certain socio-economic arrangements are to the achievement of social harmony or, to use the terminology of functionalism, how well is the function of tension management performed. After all, while different systems imply different methods of mitigating or solving the economic, social and political power struggle, the condition of social harmony as such is not bound up with and can be postulated for any particular social system.

This last illustration leads to the interesting and controversial issue of the possibility of a universal normative system. Up to this point we have argued that the evaluation of one cultural complex within the context of the goals or ends of another culture is methodologically unacceptable. The basic structural-functional approach which we have indicated would be more acceptable contains no criteria for a comparative evaluation of economic systems. Each system can be evaluated only within its own culturally determined axiological context. Although it is beyond the scope of this paper to defend the proposition that objective cross-cultural normative evaluations can be made, we believe that in principle they are possible. If "the good" can be operationally specified in relation to human needs and if there is some essential core of "humanness" which transcends individual cultures, then any statement about "good" or "better" has descriptive meaning which can, in principle, be affirmed or denied by referring to the human needs involved and the particular external circumstances. This proposition, in essence, asserts a means-ends continuum in which just as the economic ends become means within the context of the

<sup>31</sup> As an example, we might point to the physiocratic reform program calling for an agricultural system of a *grande culture*, a program, however, which obviously ran counter to the requirements of the French Revolution.

ultimate cultural ends, these latter ends become means within the even larger context of a universal humanity. Within such a system there are no absolute moral first principles as such but rather a commitment to attempt to maximize the fulfillment of human needs within the innumerable situational contexts which arise.

This principle is fundamentally different from the neoclassical principle of consumer sovereignty or the principle of democratic voting. The normative issues would be decided not by aggregating preferences or counting votes but by the scientific investigations of psychologists, sociologists, economists, etc.

Admittedly such a procedure is in its infancy. However, such thoughtful books as Abraham H. Maslow's *Toward a Psychology of Being* furnish a tentative beginning. In the meantime primary reliance will have to be placed on the procedure of judging the performance of an economic system in the context of the cultural matrix of which it is a part.

#### IV

THE LAST PROBLEM to which we would like to address ourselves concerns the potential sources of change in the economic subsystem; and, in this context, a few words must be said regarding the so-called convergence hypothesis. One of the standard criticisms of the structural-functional approach is that it possesses a built-in bias in favor of the status quo and that it is inherently conservative because of its claim that the only systems of theoretical interest are those at or very close to a state of equilibrium. For our purposes, however, this criticism is irrelevant. Before any meaningful discussion of change can be embarked upon it is imperative, even logically necessary, that the constituent variables of the system have to be identified, as well as the existing functional and causal relationships between them. Among the elements considered susceptible to change, for our purpose of analysis, we definitely have to count the value patterns of the normative order. While they are most likely to change at a much slower pace, due to their pervasiveness and the integrative function they perform in the interest of internal stability, they should, under no circumstances, be regarded as being immutable.

As a matter of fact, an unduly dogmatic insistence by the leading power elements on the ultimate truth of certain ideologies may result in unfortunate and distorted actions which will interfere with the realization of the true aims. Such a plight can only be remedied if there exists a sufficient enough flexibility in the normative order to make whatever adjustments may be necessary in the light of the requirements of reality. Paradoxi-

cally, at any given point in time, the very absence of such a minimum degree of flexibility may be the source of abrupt, that is revolutionary change. For a more gradual or smoother though nevertheless still fundamental change an intelligent dialog between the "conservative" power elements and those who have developed a "counterideology" must take place. Whether or not this will be possible is, of course, a function of the permissiveness of the system and if such discussions do occur of how flexible and accommodating the prevailing value system is in terms of potential changes. Again the situation of the intellectuals in the Soviet Union as well as the liberalization drive in Czechoslovakia would make fitting case studies.<sup>32</sup>

Despite the de-Stalinization drive in the Soviet Union no fundamental changes have been made possible largely because the ruling circles there have attempted to retain ideological purity. It is for this reason that those intellectuals who have begun to question some of the basic premises of the system (without, however, suggesting a total break with the major value and social control patterns), have been met with considerable suspicion and ill will to say the least. Thus, if potentially far-reaching criticism is blocked, the only changes possible are those of a superficial ideological readjustment permitting but minor functional redefinitions which, in turn, allow for nothing beyond severely constrained structural reorganizations.

In terms of the preceding analysis we would argue that the formulation of the so-called convergence thesis represents an unfortunate failure to realize the essential comprehensiveness of the two major competing economic systems. Any justification of this hypothesis by reference to the relevant economic reforms in the Soviet Union is but another example of the fallacy of misplaced concreteness resulting from the above-discussed autonomy claim of strictly economic analysis. The implications of economic reforms for potential fundamental changes in the system will only become clear once the existing fusion of economy and polity in the Soviet Union has been properly considered. As long as there is no perceptible change in the pervasive role of the Communist Party, the guardian of ideological purity, with concomitant relaxations in some of the basic political and economic (especially property) relations any convergence hypothesis is more than premature. Any movement of the system is not so much towards capitalism but rather more like revolving around an

<sup>32</sup> Parsons argues, for example, that whenever new developments in the realm of social and intellectual thought occur there is a tendency to make them compatible with and integrate them into the existing framework of thought with the least possible modification of the latter in a fashion analogous to the "least action" principle in physics. (Parsons, *The Structure of Social Action*, *op. cit.*, p. 175).

occasionally shifting axis.<sup>33</sup> The same holds true with respect to the increasing scope and functions of the United States government. To read this as a movement towards socialism seems to us to be equally mistaken.

While the achievement of a certain level of economic development is not contingent upon any one social or political arrangement, for a change in the basic features of the system that has reached this level a concomitant adjustment of the social and political institutions is necessary. Therefore, given the normative order, that is, a certain system of social control and institutions, we can ascertain what changes can be realized. Also, we can postulate the required changes in terms of the basic values and structure to facilitate the type of movement of the system as a whole which can be termed convergence.

In conclusion, we would like to issue a frequently made though seldom heeded warning against an indiscriminate attaching of labels to economic systems. It is hardly ever made explicit whether the basis for certain classifications of different systems is "ideal-typical" or "real-typical" or some inadmissible combination of the two. Furthermore, simply to speak of mixed systems, especially within the too narrow economic context, does not get us very far either, particularly if no "ideal-typical" polar concepts are established simultaneously to permit plausible determination of the various "mixes" possible. In this age of empirical studies and attempts at verification it is unfortunate that such lines of investigation, which also isolate the economic features of a system from the social milieu, are so dominant.

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*Riverside*

<sup>33</sup> Matters were somewhat different in Czechoslovakia where a shift away from doctrinaire communist ideology—without sacrificing their professed ends—had led to basic adjustments in the social control mechanism. This demonstrates the requirement for mutually compatible changes in the various subsystems for basic changes in the social system to occur. In addition, it seems that the enculturation process in that country was, in the light of its traditions and history, simply not as successful as in the Soviet Union.

### *USSR Cooperates in Weather Watch*

THE U.S.S.R. IS BUILDING 10 new research ships, some of which will supply vital data for the World Weather Watch program during its first phase, 1968–71. The program calls for at least seven new weather ship stations to fill "gaps" in the Southern Hemisphere. [From the U.S. Department of State.]

# The Role of Scientific Planning in the Governmental Process:

## *The West German Experience*

By KLAUS LOMPE

### I

#### The Problem

IN THE FEDERAL REPUBLIC of Germany as in other democratic countries of the free world awareness has grown that politics require long-term and coherent planning if the problems of modern industrial societies are to be solved. It is becoming more evident that those concerned with future planning are dependent at all levels on the assistance of social scientists. The relationship between science and politics, however, particularly in Germany, is heavily burdened even today with misunderstandings, historical conflicts, and prejudices. The gulf between "intellect" and "power" has developed in a century-long process of constitutional history. In some respects one may consider the clashes between student movements and the people in power, the so-called 'establishment' of society, as a current example of this conflict.

Many hypothetical explanations exist for the sensitivity and aloofness of a great number of social scientists toward political problems. In 1881 a publisher founded a newspaper revealingly entitled "Newssheet for the educated of all classes—a newspaper for non-politicians." In a prospectus for it the publisher wrote this sentence which has become a proverb: "Politics ruins character." The events of the period of Nazism in German history with its consequences for intellectual life and similar occurrences in the contemporary histories of the other States of the Communist totalitarian bloc often determine the opinion of those who favor the separation of "intellect" and "power" or who adhere to the position that politics and morals exclude each other.

The tradition of political thought in Germany, which in a romantic, idealistic way conceives of politics primarily as an art, corresponds with this view and with the widespread discrediting of politics as 'a dirty business' among the liberal bourgeoisie. Thus it has come about that the lack of a social science basis in politics frequently is accompanied by the lack of a political orientation in the social sciences. Despite continuing widespread prejudices, however, large numbers of those involved on both

sides have undergone a gradual shift in thinking; and intensified contact between social scientists and politicians is taking place.

People have gradually realized that in a dynamically developing society science can in no meaningful way be looked upon as an autonomous area apart from the "non-scientific world," free of every political responsibility. Moreover consistent governmental policy can hardly be put into practice any longer without assistance from the social sciences.

In the course of history one can observe that fruitful teamwork occurs with a certain regularity especially in times of political and social upheaval. Then scientific counseling in policy-making can easily turn into leadership, as has often been the case in the intellectual history of mankind.

Novel conditions wake the need for new conceptions. Research scientists perceive this, and those in practical work become aware that the patterns of thought which they have taken over and used no longer suffice. At this stage scientists often rise from the position of expounders to that of enactors of new ideas.<sup>1</sup>

Scientific counseling can turn into leadership especially when the counselors are collaborating with an opposition that has formed because an existing regime has failed. Such a process took place in the territory of the present German Federal Republic, when, immediately after the collapse of the Nazi regime, people in politics lacked a sense of direction in the face of many fundamental questions. Only a few outstanding politicians fully recognized what was involved in shaping a new society:

At that time a number of scientists of varying political sympathies appeared with conceptions and themselves took over putting them into practice within the parties or in the rapidly increasing socio-political institutions and groups outside the parties, not without success with the parties and governments, also to a certain extent with representatives of the occupation powers, who perceived the Germans' own initiative to create a new political order.<sup>2</sup>

<sup>1</sup> G. Weisser, "Das Problem der systematischen Verknüpfung von Normen und von Aussagen der positiven Ökonomik in grundsätzlicher Betrachtung, erläutert an Hand des Programms einer sozialwissenschaftlichen Grunddisziplin aus Empfehlungen und Warnungen." (Working paper for the conference of the "Gesellschaft für Wirtschafts- und Sozialwissenschaften," unpublished manuscript.) Bad Homburg 1962, p. 6. For the problem of "science as the contributor of ideas and conceptions" see e.g.: Y. Dror, *Public Policymaking Reexamined* (San Francisco: Chandler, 1968); A. Etzioni, *The Active Society* (New York: The Free Press, 1968) and K. Lompe, *Wissenschaftliche Beratung der Politik, Ein Beitrag zur Theorie anwendender Sozialwissenschaften* (Göttingen: Schwarz & Co., 1966).

<sup>2</sup> G. Weisser, "Kurze Orientierung über das System der Gesellschaftspolitik" (unpublished manuscript, Göttingen 1967) p. 1. Concerning the concept of political parties on foreign policy during this time see: H. P. Schwartz, *Vom Reich zur Bundesrepublik, Deutschland im Widerstreit der außenpolitischen Konzeptionen in den Jahren der Besatzungsherrschaft* (Neuwied: Luchterhand, 1966).

But interest in scientific advice declined, perhaps for many reasons. One of them certainly was that, after the basic initial decisions had been reached, conditions became strongly resistant to change. Scientists became discouraged because their findings often were used merely as a facade for practices that were in reality incompatible with them. And other forms of subterfuge or misuse of science occurred.<sup>3</sup> In addition, the fundamental decision was made to dispense with political planning as far as possible. It became a political article of faith in the German Federal Republic that its social policy was such that social development "took place entirely without plan, in fact with a distinct aversion to the very idea of planning."<sup>4</sup>

Thus for a long time the question of the need for and potentialities of political planning was hardly raised in the German Federal Republic. Doctrinaire points of view in the controversy over the importance of free enterprise and of planning within the market system prevented practical politicians from dealing with questions of coordinated planning, for example in public finance, infrastructure, education, etc. At the same time they also prevented social scientists from giving serious attention to the problem of what economic, social and political institutions can be planned with familiar planning techniques and what cannot, recognizing that there are various levels at which cost/effectiveness judgments can be made.

Partly as a result of severe misadventures in various areas of society and in the subsystem of politics (especially in the machinery of government in the narrow sense), a keen discussion began a few years ago on the necessity for political planning. In the official program of the present government, in the "report on the state of the nation," in the programs of action of the democratic parties, in parliamentary debates on aid to science and education, strong appeals have been made for some time now for long-range programs for society and for more political planning. Even among the public, the demand for a "modern," "rational," or "constructive" social policy is increasingly linked with the demand for more planning. But it is precisely the planners who urgently need comprehensive help from social science. Hence the call for planning led to an intensive revival of the idea and the practice of scientific counseling in policy-making.

<sup>3</sup> For more detail, see: K. Lompe, "The Role of the Social Scientist in the Processes of Policy-Making," *Social Science Information*, 6 (1968), pp. 158-75.

<sup>4</sup> R. Dahrendorf, "Deutsche Gesellschaft im Wandel," in H. J. Netzer (ed.), *Adenauer und die Folgen*, (Munich: Beck, 1965), p. 236. See also: H. J. Arndt, *West Germany: Politics of Non-Planning*, Syracuse, N.Y.: Syracuse University Press, 1966).

In the big debate in the Bundestag the government and the spokesmen of all political parties represented in parliament stressed the importance of applying new and more effective forms of scientific counseling in policy-making and pleaded for a more active participation of social scientists in the preparation of political decisions.<sup>5</sup>

## II

### Counseling to the Federal Ministries

FUNDAMENTALLY, it can be said that the desire for social scientists' advice is shown very clearly by the formation of scientific commissions, among which the commissions set up with the federal ministries are of special importance. During the Weimar Republic these kinds of boards were unknown; the so-called *vorläufige Reichswirtschaftsrat* (preliminary economic council of the Reich) was just an institution approximating a syndical form of the State. Only in 1949-50, when the federal government was being set up, were a number of scientific commissions attached to the federal ministries. The earliest official initiatives of this kind were taken by the states of the British-occupied zone in 1945 and, to a larger extent, by the *Zonenbeirat* (consultative administrative body in the British zone) in 1946, the first indirectly elected German parliament at a supra-state level. At present, five such commissions are attached to the federal ministries. They are composed entirely or almost entirely of active university teachers. These are the commissions to the Ministries of Economics; Finance; Commerce; Economic Cooperation, and Food, Agriculture and Forestry. Other commissions might also be considered as scientific ones but in their membership not only the social sciences but also certain interest groups are represented. Of these, the following should be named: Scientific Commission for Family Affairs to the Ministry of Family and Youth Affairs; Social Commission for all branches of compulsory social security and accident insurance which advises the Ministry of Labor on problems concerning the adjustment of pensions to fluctuations in the economy; Commissions for City Planning, Regional Development, and Construction Research with the Ministry of Housing and City Planning; the Research Commission for Problems of German Reunification of the Ministry of All-German Affairs; and finally the Commission for Inter-

<sup>5</sup> See the protocol of the 152nd session of the 5th German Bundestag on Feb. 7, 1968. Regarding the basic attitudes of leading politicians of the three parties represented in the Bundestag towards the problems of scientific counseling in policy-making and the need for new forms of counseling, see: H. Flohr and K. Lompe (eds.), *Wissenschaftler und Politiker—Partner oder Gegner?* (Göttingen: Schwartz & Co., 1967), p. 19ff. and p. 29ff.

nal Leadership of the Ministry of Defense. Some commissions are also under the aegis of *several* ministries, but this is not the usual case. Most of them belong clearly to one ministry only, with, in a few cases, an institutionalized relationship for information or advice to other ministries.

A minister has five ways of obtaining an advisory commission: by 1) decision of the cabinet; 2) decision of the parliament (Bundestag); 3) administrative agreement; 4) law; 5) ministerial decree.<sup>6</sup> Besides counseling institutionalized in commissions, a special counseling role is played by ad hoc committees, individuals, commissioned and ministerial research projects, and, finally, by research institutes and autonomous scientific boards. Thus a great number of research projects on concrete specific subjects are today contracted out to the universities. But because of the lack of corresponding empirical investigations<sup>7</sup> no exact data can be given on the extent of the activities of the university institutes. Although many individual university institutes consider it one of their tasks to work up useful information for people in politics, one cannot say that the universities as such have yet officially accepted counseling the government in the social sciences as one of their tasks.<sup>8</sup>

If one wishes to categorize the various scientific advisory boards according to still further criteria into a typology, then a good distinguishing characteristic is the subject of their fields of work.

<sup>6</sup> See: D. Dreitzel, "Die Bundesregierung und ihre Wissenschaftler," in *Atomzeitalter*, (1966), p. 296ff.

<sup>7</sup> Regarding the first investigations see: H. Friedrich, "Staatliche Verwaltung und Wissenschaft," in *Atomzeitalter*, (1966), p. 300ff. There it is reported that the ministerial bureaucracy regards counseling through individual reports very favorably, if the university institutes stay in permanent contact with the ministries awarding the projects.

<sup>8</sup> From the abundance of independent or government-backed institutions of political counseling I shall only mention one or two, such as the Research Institute for Social Policy and Advisory Social Sciences in Göttingen, which is mainly concerned with fundamental problems. The findings of this institute deal with both the specifically scientific problems of the applied social sciences, as well as the question of a suitable organization of scientific counseling and organization in accord with parliamentary democracy. Investigations into problems of major research institutes are being carried out mainly by the "Studiengruppe für Systemforschung" in Heidelberg. In recent years in the German Federal Republic as in almost all industrialized societies, a need for a new branch of research has developed, namely Future Research. Today it is no longer a question whether "futurology" has the right to exist, but a question of its usefulness, its limits, and its organization. Conclusions in this field that have been worked out so far concern not only single areas of society in which planning seems to be the only means of meeting problematical developments as foreseen by experts e.g. populations development, traffic, automation, etc., but also the drafting of possible "futures," models of a new world, the founding of "forecasting institutions" etc. See e.g. K. Lompe, "Problems of Futures Research in the Social Sciences," in *Futures*, Vol. 1, No. 1 (1968), pp. 47-53; Lompe, "Das Verhältnis der Zukunftsforschung zur Wissenschafts- und Regierungslehre," in *Futurum*, Vol. 2, No. 1 (1969), pp. 5-32 and H. Klages, *Soziologie zwischen Wirklichkeit und Möglichkeit* (Köln-Opladen: Westdeutscher Verlag, 1968).

Three groups can thus be distinguished: a) boards whose sphere of activity more or less directly touches general political and social value judgments, b) boards of a more specialized character, c) boards in whose activities value judgments play almost no role.<sup>9</sup>

The advisory boards discussed in the following passages fall almost exclusively into the (a) category, because naturally working out recommendations, they cannot disregard general conceptions of social order, even when only minor details are to be discussed. This brings one back to a discussion of the commissions to the federal ministries, already mentioned above.

The organizing and working principles to be followed by the advisory boards have been discussed intensively in scientific literature, where the following postulates have become crystallized:

1. Right to initiate proceedings concerning public statements.
2. Duty on the part of the government to present the findings to the parliament.
3. Obligation on the part of the government to comment in parliament on the findings.
4. The concept of the "hearing," that is, the right to hear any groups or persons publicly.
5. Obligation to publish the findings.
6. Duty to cite in detail the minority votes in the reports.<sup>10</sup>

The boards mentioned above are almost completely free to choose their research topics. Besides working on subjects desired or suggested by the individual ministries, they have, at least formally, the possibility of investigating problems which they themselves consider to be important. This has been the usual practice of many commissions. The official suggestions from the ministries have mostly been loosely formulated, such as a request for an opinion on a certain topic.<sup>11</sup> Many factors, *e.g.* the stage of development of the science of economics, have made it possible for social science to achieve great influence on the formation of economic life, especially after 1945 and largely through the Economics Ministry's commission set up in 1948. Through its reports, particularly on convertibility and European integration, it has supplied important contributions to a process of true symbiosis between social science and economic policy.

<sup>9</sup> Regarding this categorization see also: D. Dreitzel, *Die Bundesregierung und ihre Wissenschaftler*, *op. cit.*, p. 297.

<sup>10</sup> See: St. Leibfried, M. Quilisch, "Planung im Sozialstaat," in *Atomzeitalter*, (1967), p. 613.

<sup>11</sup> See: D. Dreitzel, *op. cit.*, p. 297.

This commission's basic organizing principles are briefly, the following:<sup>12</sup>

1. The commission is an honorary board of professors. Every member must belong to the faculty of a university.

2. The commission is completely autonomous in its selection of members to fill vacancies. (The original choice was made by the administration. The commission's nominations have always been followed by the ministers.)

3. As with the other commissions this commission's autonomy includes choice and handling of the subjects investigated. Most of the initiative in selecting topics have come from the ministries, which put forward problems of interest to the government. Decisions concerning questions and answers are made by the scientific commission only, while the minister determines exclusively the date of publication of the results. So far all findings have been published, although in some cases with considerable delay. In this respect it is of importance that in the eyes of the public the scientific commission is virtually considered an official body.

4. The respective minister has to give information to the commission and to publish the results of its work sooner or later. He is not obliged to ask for the commission's opinion on specific questions, or to express his own opinion on the commission's reports, or even to take the reports into account. It has been stressed that the commission's recommendations are officially addressed to the Federal Minister of Economics. This fact creates special problems in connection with the far-reaching activity of the commission. They are brought about by the specific constitutional position of the Minister of Economics within the federal government. His executive responsibility covers the entire realm of economic policy, while his authority to give directives embraces only very limited areas. This discrepancy between basic general jurisdiction and the highly specialized directive authority is the essence of the problem. Jurisdiction over the control of business cycles belongs to the Federal Bank and the Minister of Finance. Jurisdiction over basic economic policy belongs not only to the Minister of Economics but also to the Minister of Agriculture, the Minister of Social Affairs and others. In the basic jurisdiction the Minister of Economics competes with the Chancellor who, according to Article 165 of the Constitution, determines the "guidelines of the current government"

<sup>12</sup> See: W. Koch, "Der Wissenschaftliche Beirat beim Bundesminister für Wirtschaft," in E. v. Beckerath und H. Giersch (eds.), "Probleme der normativen Ökonomik und der wirtschafts-politischen Beratung," *Schriften des Vereins für Sozialpolitik*, Neue Folge, Vol. 29 (Berlin: Duncker & Humblot, 1963), p. 405ff.

and is responsible for them. Principles of economic policy are always part of the guidelines of the current government.

Questions of delimitating and coordinating the counsel given the Chancellor are problems which, particularly today, are at the center of discussion. The scope of activity of the Economics Ministry's commission ranges from basic economic policy to safeguards for the competitive system, problems of economic fluctuations, and wage policy. Evaluation of the effectiveness of the reports must be left to the historical analysts. The influence of the commission's advice is clearly seen in the ministry's policies on European integration.<sup>13</sup> This is in contrast to the sporadic use of scientific counseling by the Foreign Office. The economics commission's systematic research made an undeniable contribution toward development of a European community. Its report served as the basis for negotiations for the development of a common market in the committee of government representatives set up by the Messina Conference in June, 1955. Important institutional and economic parts of the so-called 'Spaak Report' (which is the basis of the E.E.C. Treaty) can be traced back to the ideas of this commission.

### III

#### Science and Parliament

IN CONTRAST to well-known experiments in the United States and in other countries, there is officially no scientific counseling to parliament in Germany comparable to the kind of counseling given to the individual ministries by the commissions. Seen in this light it seems that the official forms of bringing science into politics are at present strengthening the position of the administration in power, when one disregards the fact that so far no scientific board has been set up to advise the cabinet or the Chancellor as such. As far as parliament is concerned, the political parties, as mentioned, have for a long time made use of scientific advisors in devising their basic programs, etc. But today there is a strong demand for more effective scientific assistance to parliament.

Complaints about the decline of parliamentarianism are common in

<sup>13</sup> See: *Der Wissenschaftliche Beirat beim Bundeswirtschaftsministerium*, Vol. 3, (Göttingen: Schwartz & Co., 1953); E. v. Beckerath, "Der Einfluß der Wirtschaftstheorie auf die Wirtschaftspolitik," in E. Topitsch (ed.), *Logik der Sozialwissenschaften* (Köln: Kiepenheuer & Witsch, 1965), p. 497ff. and G. Zellentin, "Wissenschaft und Europapolitik der Bundesregierung," in *Politische Vierteljahresschrift*, Vol. 7, 1966, p. 180ff. For an appreciation of the activities of the commissions on housing, see: W. Wilhelm, *Wissenschaftliche Beratung der Politik in der Bundesrepublik Deutschland* (Berlin, Köln, Frankfurt: Beuth-Vertrieb, 1968).

almost all countries.<sup>14</sup> There are several reasons for this development, but a decisive one is parliament's lack of its own sources of information. The members of parliament are therefore dependent on the information they get from the government, interest groups, the press or at best the members of the various specialized committees, without themselves being able to evaluate this information which is often one-sided. Therefore many politicians and social scientists have long been calling for a reform of parliamentary institutions and procedures. Stemming essentially from the middle of the past century they are in no way adequate for today's requirements. The members of parliament are asking to organize appropriate systems of information (data banks) for legislation and supervision. It is obvious that if parliament's supervisory control is to become stronger, one must take government planning into account and have a better system of obtaining information. Such systems of information must be so set up as to be available equally to both cabinet and parliament.

In Germany critics are also discussing whether special agencies similar to the Legislative Reference Service of the United States Congress or whether scientific advisory boards following the model of the Royal Commissions in the Anglo-Saxon countries should be attached to the parliament.<sup>15</sup>

Only recently has parliament to a greater degree exercised its right to hear independent experts in public information sessions, to install committees for the investigation of particular problems, and to request expert opinion on them. Naturally, all these institutional efforts are hardly sufficient to produce independent representatives who know how to handle

<sup>14</sup> For a more optimistic point of view see e.g., R. Butt, *The Power of Parliament* (London: Constable, 1968).

<sup>15</sup> The most radical reform plans of the political scientist Eugen Kogon aim for the establishment of a new institution: a kind of expert commission in addition to the legislative and the executive bodies. Kogon has state institutions in mind in which experts a) systematically observe and analyze the development of society, b) identify all the social needs that are becoming pressing, c) work on, that is to say, examine and put into shape every proposal put forward by an interest group which claims it to be a matter for public action. (Here group interest receives its first instance of legitimization, although this is accorded under supervision.) The results of (a) are published continuously; the findings of (b) are given to the Bundestag and the government; recommendations of (c) are forwarded to an Economic, Social, and Cultural Council in which all organized social forces are represented by their leading associations. The Economic, Social, and Cultural Council examines the proposals submitted by the expert commission and either rejects or recommends them. If a proposal is recommended, it is forwarded, with indication of majority and minority votes, to the Bundestag and to the appropriate minister. It is up to the parliamentary parties and the government to propose bills, when it seems expedient to them, on the basis of the preliminary work of the expert committee and the council. Thus Parliament becomes free to practice politics in the true sense of the word. (E. Kogon, "Verteidigung unserer Möglichkeiten," in Erich Kuby, *Franz-Joseph Strauß* (Wien, München, Basel: Desch, 1963), p. 306ff.

sources of information. Forms of active democracy, initiative, and supervision depend, of course, to a great degree on the quality of the parliament. Politicians must be willing to educate themselves and must realize that well-founded universal thinking adds greatly to their ability to make use of the knowledge of experts in a more fruitful and less dangerous way.

#### IV

##### Counseling to the Public

###### *The Expert Council for Reports on General Economic Development.*

THE MOST LIVELY DISCUSSIONS in the German Federal Republic have centered on the establishment and the initial reports of the so-called Expert Council for Reports on General Economic Development which was appointed in 1964. So far advice has been addressed to the government—particularly the ministries—and parliament. But here we find another recipient of this advice, the public. By law not only the offices responsible for economic policy, but also the entire public has been explicitly declared the recipient of its advice. Therefore the public is one of the sponsors of the council's advisory activity.

The council consists of five members<sup>16</sup> who are appointed by the President of the Federal Republic on the basis of government recommendations. Almost all specific directions of the law which apply to the institutionalization of advisory activity reflect the basic decision that besides appealing to the offices responsible for economic policy, the council should appeal to the public and help it to form its opinions. The law prescribes that the Expert Council should be independent in its activities.

Besides a compulsory annual report and special reports which are compiled at the discretion of the council, reports are provided for the government at its request. But their content is not up to the discretion of the government but must stay within the framework of the commissioned report as defined by law. The decisive point is that the whole activity must take place in public. The current report is forwarded to the government, which must present it immediately to the legislative body. At the same time the Expert Council publishes its recommendations.

The government is under obligation to take a stand on the annual report before parliament within eight weeks after receiving it. In its statement the government must set down the conclusions particularly for economic policy which it draws from the report.

<sup>16</sup> In 1968 one of the members withdrew from the council because of differences with his colleagues over the question of the pro's and con's of an upwards revaluation of the German mark.

The content of the counseling function is firmly laid down in the law. It consists of investigating how, within the framework of a competitive market economy, price stability, a high level of employment, and an external balance of payments can be maintained and a steady rate of growth achieved. Special reports must be submitted when developments threaten the above aims. These reports are also forwarded to the federal government and are published one week later by the Expert Council, or, in agreement with the Minister of Economics, at a later date. Advice to political bodies in a more restricted sense is thus secondary to disseminating information.

In some respects the role of the Expert Council resembles that of a parliamentary opposition, as it can always reproach the government with the opportunities it has missed in the past and the future opportunities it has ruled out.<sup>17</sup>

By means of a further strict formulation of the intent of the law, an attempt is made to counteract the danger that the board, through the public and its widespread overconfidence in science, could gain undesirable influence over policy-making. The Expert Council has been forbidden to make recommendations for particular measures of economic or social policy. Its investigations on possible future developments should rather be based on alternative assumptions about measures to be taken on economic policy.

The opinions of critics on this new institution differ widely. On the one side some legal experts consider the establishment of this institution to be a violation of the constitution, labelling the Expert Council a "second government organ" and characterizing its reports as a legislative intervention of the federal government.<sup>18</sup> On the other side some critics among social scientists consider the legal authority of the Expert Council utterly inadequate, as it restricts a priori the scope of action of the scientific board.

New problems naturally arise for a parliamentary democracy when a board is commissioned by the public and in some ways is pitted against

<sup>17</sup> See: O. Sievert, "Die wirtschaftspolitische Beratung in der Bundesrepublik Deutschland," in H. K. Schneider (ed.), "Grundsatzprobleme wirtschaftspolitischer Beratung," *Schriften des Vereins für Sozialpolitik*, Neue Folge, Vol. 49 (Berlin: Duncker & Humblot, 1968), p. 31.

<sup>18</sup> See: E. W. Böckenförde, *Die Organisationsgewalt im Bereich der Regierung* (Berlin: Duncker & Humblot, 1964), p. 258, or C. H. Heinze, "Der Sachverständigenrat zur Begutachtung der gesamtwirtschaftlichen Entwicklung und Umbildung der Verfassung," in *Der Staat*, 6 (1967), p. 439ff. For a critical position see: K. Lompe, "Politische Wissenschaft und politische Planung," in *Die Mitarbeit*, 17 (1968), pp. 23ff. and F. Knöpfle, "Die Beratung der Verfassungsorgane in geschichtlicher und rechtlicher Sicht," in *Bayrisches Verwaltungsblatt* (1967), p. 401ff.

the government. It is also noteworthy that the possibilities for a public scientific debate on political subjects ultimately depend not only on the maturity of the politicians but also on the maturity of the public. Nevertheless it must be emphasized that these boards can originate new forms of democratic activity at a time when generating initiatives has become a problem in highly developed countries, because, as in most industrial societies, the traditional sources of initiatives have been exhausted. It is apparent that precisely those democratic institutions which are suited to curbing and regulating powerfully organized interest groups are no longer capable of taking initiatives that can influence the future.<sup>19</sup>

With regard to the reports of the Expert Council, the government still has the opportunity in any case to express well-founded dissenting opinions on the recommendations of the Council. In fact, in this case, the government is obliged to do so by law. The prerequisite is that a council be able to develop well-founded, comprehensive proposals and that it disclose the logic and data on which it based its conclusions. But many critics believe that the very limitations of the law prevent this. These shortcomings spring from the fact that the Council is forbidden to make recommendations, from the vague formulation of the aims prescribed in the law, and from the demand that the Council confine itself to these aims. The set-up and function of this Expert Council, together with the fact that it is legally prohibited from making concrete policy recommendations, corresponds, in the opinion of many scientists, to the principles of the "decisionistic" model of counseling. Science is here condemned to being primarily instrumental. Scientific statements must confine themselves purely to discussing the compatibility of means with concrete goals.<sup>20</sup>

In practice, one expects or hopes *a priori*, as argued by specialists on the subject, that expert councils will not keep to the legal formulation of their function. To quote an experienced counselor, "Again and again the responsible authorities declare that they are waiting for 'proposals,' normative recommendations from the councils—but that of course they do not feel bound by them. Thus one has tried at least formally to solve

<sup>19</sup> The cliché, "the end of ideologies" is true at least in this respect. See: R. Dahrendorf, *Conflict after Class* (London, 1967) and K. Lompe, *Wissenschaftliche Beratung der Politik*, *op. cit.*, p. 29ff.

<sup>20</sup> See e.g.: W. Bauer, "Der Sachverständigenrat. Einige Bemerkungen zu seinem Wesen und zu seinen Funktionen," in *Theoretische und institutionelle Grundlagen der Wirtschaftspolitik*, ed. by H. Besters (Berlin: Duncker & Humblot, 1967), p. 352ff. For a detailed presentation of this and other models of counseling in policy-making now under discussion in scientific literature, see: K. Lompe, *Wissenschaftliche Beratung der Politik*, *op. cit.*, and K. Lompe, "The Role of the Social Scientist in the Processes of Policy-Making," *op. cit.*

the legal problem."<sup>21</sup>

The public also often complains that the Expert Council, when adhering strictly to its task as stipulated in the law, has confined itself to a summary of more or less familiar data and that it gives no interest group an indication as to how it should act within the context of the whole society. One does not hold the social scientists responsible for this state of affairs but rather the stipulations of the law, which are considered to be the critical weak point. It is said that the reports are proof of the impossibility of "pointing out faulty developments and opportunities for correcting them without making any recommendations for particular measures in economic and social policy," as the law phrases it. Critics believe "that to abide by the letter of this law is impossible for men who have good reputations to keep. Self-respect and professional background give experts of distinction no other alternative than to make recommendations."<sup>22</sup>

Academic opinion also regards modern economic policy increasingly as the science of dealing with conflicts of goals. Thus it is a discipline which must combine factual statements with value judgments on the priority of goals and on the willingness to take risks. Another difficulty is that the Expert Council is legally bound to a list of aims which many feel do not suffice for fruitful suggestions.<sup>23</sup> So there remain two equally problematic ways out: on the one hand there is the possibility—and it has already been used by the Expert Council—of introducing further aims tacitly. Or, in working out the recommendations, political aims which are outside the given list can be disregarded and one's guilty conscience appeased by the *ceteris paribus* clause. One must then be aware that if particular political aims are disregarded the concrete situation can develop quickly into a Platonist normative model. Critics believe that to disregard all aims outside the legal list has serious consequences. The goal of European integration, the distribution of income and wealth, or changes in economic institutions—which after all should always be factors in determining political decisions—are affected by such a position as indeed is a particular measure's political effectiveness. To disregard such aims may mean that the council's suggestions in economic policy are not only

<sup>21</sup> H. Meinhold, "Fachliche Ergänzungen des behördlichen Sachverständes" (insbesondere durch Beiräte, Fachausschüsse und Fachgutachten) in "Sachverstand und Verantwortung in der öffentlichen Verwaltung," *Schriftenreihe der Hochschule Speyer*, Vol. 30 (Berlin: Duncker & Humblot, 1966), p. 130.

<sup>22</sup> F. Swiertz-Sporck, "'Fünf Weise' ohne Publikum," *Der Volkswirt*, 19 (1965), p. 45.

<sup>23</sup> See particularly: G. Weisser, "Beim Rat der Gutachter steckt der Teufel in den Details," in *Welt der Arbeit*, April 12 and 19, 1962.

occasionally but predominantly irrelevant for practical politics.<sup>24</sup>

The narrowly limited stipulations of the law have resulted in the fact that during the four-year existence of the Expert Council, no minority reports have yet been submitted, although minority reports usually comprise the spice in counseling. It should be mentioned that two of the council's five members have been appointed not only because of their expert knowledge but also because of their political affiliation. This can be regarded as evidence of the impossibility here of pluralistic statements of opinion, which are after all essential for social science, since it tests its certainty by considering difficulties. Therefore critics also believe that one will do the social sciences no good by replacing the diversity of opinion and the competition of ideas, necessary for staying in close contact with reality, with a board that the administration often conveniently regards as representative of all science.<sup>25</sup>

To mitigate these problems, it has been suggested that this board should be attached to the political institutions as a true counseling commission so that not all statements from the Expert Council on economic policy come, as it were, from the outside. Making the board independent, without contact with the politicians carrying out decisions, implies a formalization of communication which is very detrimental to continuous interpersonal contact, although this seems to be essential for the lasting transmission of ideas. The practical chances for effectiveness of the Expert Council can only be greater if it is no longer so remote from the potentialities of politics as they are understood by politicians, so that the council can much more readily take into account in its conceptions the conditions under which a policy can be carried out.

The recipients of advice, above all the ministerial bureaucracy, often voice such criticism of the entire advisory system in the German Federal Republic as well. This has been shown by recent empirical research. Counselors are accused of over-abstractness of being too far from political reality, of having no appreciation for the political process, and, finally, of not understanding that the decision to give advice also implies contact, in the political realm, with partners who have to make value judgments to translate ideas into practice.<sup>26</sup>

<sup>24</sup> See: O. Sievert, "Die wirtschaftspolitische Beratung," *op. cit.*, p. 46.

<sup>25</sup> See: A. Müller-Armack, "Wissenschaft und Wirtschaftspolitik-Erfahrungen im Laufe ihrer Zusammenarbeit," in *Wirtschafts- und Finanzpolitik in der sozialen Marktwirtschaft*, ed. by A. Müller-Armack u. H. B. Schmidt (Stuttgart: Seewald, 1967), p. 80ff.

<sup>26</sup> H. Friedrich, "Staatliche Verwaltung und Wissenschaft," *op. cit.*, p. 305, and H. Friedrich, "Verwaltung und Wissenschaft," unpublished manuscript, Göttingen 1968. The opinion on the success of counseling by boards of big-name scientists differ widely. While the Minister of Research in the most recent debate on science expressed the point

The outcome is that new and more effective ways of cooperation between science and politics are being discussed.

V

**The Planning Staff in the Office of the Federal Chancellor**

COORDINATION, GUIDANCE, AND INITIATIVE are the three essential and inter-related functions of any government. Difficulties in this area are typical of large organizations, above all in an industrial society. The more extensive and complicated an organization becomes, the more difficult it is to bring its individual activities into harmony, to guide it, and to demand more of it than just to hold its own. Experts' criticism of the governmental machinery in the German Federal Republic has long been quite vehement. These critics emphasize that routine prevails, that hardly any sensible coordination has taken place, that ministerial problems predominate in cabinet sessions, that only seldom have top-level problems been discussed, and that continuing developments are often a result of non-integrated partial solutions. Besides discussing the fundamental transformation of the machinery of government, people have long voiced the expectation that the introduction of new scientific boards could be of great advantage. As has been stressed before, the Federal Republic, unlike the White House in Washington with its widely known advisory boards, has previously had no advisory board attached to the office of the Federal Chancellor.

Another argument for the establishment of a central social science advisory agency for the federal government is that it would provide for systematic scrutiny, evaluation, and application of scientific research findings and advice, worked out by the various institutionalized advisory boards. Thus their results would be of optimum use in the formation of political opinions and decisions. Political scientists, especially, demand that this central advisory board should offer the Chancellor decisive help in interpreting and executing his authority over policy guidelines. It is

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of view that such honorary activity had proven itself in principle, representatives of the administration criticize these boards very sharply. They stress that they have developed into boards increasingly occupied by "traveling consulting professors." "These kings of institutes have often become estranged from their fields, are insufficiently prepared for giving advice, do not allow young scientists to move up because of their self-coopting system of selection, and in the course of time confuse counseling with voting." In Friedrich's investigation, 103 ministerial civil servants who have experience in scientific counseling, were interviewed. Ninety-two replied that in working with scientific counselors they ran into difficulties and conflicts. None maintained that scientific counseling is unfruitful or has no influence or success. Its critics concentrate particularly on points which have a dampening effect on satisfactory cooperation. Among them three points predominate, which are closely related to each other: 1. the organization of counseling; 2. the work procedures and accomplishments and 3. the present-day structure of the organization of science in the German Federal Republic.

obvious that the agency which has to do with the interpretation of policy guidelines and with the tasks, decisive for government policy, of coordination of the initiatives coming from the individual ministers, requires advice especially from political science and sociology in cooperation with other social sciences. Authority over the general policy decisions ("*Richtlinienkompetenz*") is ultimately an instrument for some overall planning.<sup>27</sup> It would be extremely unfruitful if one did not combine and coordinate planning in the office of the Chancellor and instead allowed further splintering off of the planning function. Especially when one is counseling a person who determines policy guidelines or a person who is opposing them, a form of counseling emerges which is based on conceptions of social policy worked out on an interdisciplinary level. These conceptions can give general orientation when they are as well grounded in social history as possible.<sup>28</sup>

In 1967, after a long discussion and in the face of much opposition from various sides, a planning staff was established in the office of the Federal Chancellor. The staff members are drawn from the administration, from practical professions, and from the sciences or related fields. The head of the staff is directly responsible to the head of the office of the Chancellor and has the right to confer directly with the Chancellor. The assimilation of this advisory board into the structure of the administration represents a certain deviation from the political practice of the post-war period, which found its visible expression in scientific commissions and the Expert Council. However, the functions of the planning

<sup>27</sup> According to Article 65 of the Basic Law, the constitution of the German Federal Republic, the "Federal Chancellor determines policy guidelines and bears responsibility for them. Within these guidelines each federal minister administers his department independently and on his own responsibility. The federal government decides on differences of opinion among the federal ministers. The Federal Chancellor conducts cabinet affairs according to standing orders determined by the federal government and approved of by the Federal President." In American literature (Finer, *Governments of Greater European Powers*, 1956; Neumann, *European and Comparative Government*, 1951; and Carter, Herz, and Ranney, *Major Foreign Powers*, 3rd edition, 1957), concern has often been expressed that by means of this constitutional regulation of the position of the Chancellor a transformation into an authoritarian system is made possible. On the other hand there are those who stress the view that in the face of present-day needs for planning and coordination in a modern social State, even countries with democratic constitutions require such a top-level instrument of leadership. These persons refer to the fact that the "personalizing of power" (Menzel) intended in Article 65 need not necessarily lead to an authoritarian or even totalitarian regime or contain anti-democratic tendencies. Security against this danger could, for example, consist in the fact that guidelines be closely bound to government programs or other programs of action and thereby to planning open to the public.

<sup>28</sup> Regarding the program of this kind of advice see: G. Weisser, *Politik als System aus normativen Urteilen* (Göttingen: Schwartz & Co., 1951) und K. Lompe, *Wissenschaftliche Beratung der Politik*, op. cit., p. 96ff.

staff in the Chancellor's office largely resemble those of the other scientific boards, and one can generally describe the essence of staff functions as that of a counseling and advance planning body. In many respects its functions, on the one hand, far exceed what independent scientific advisory boards have so far been authorized to do; on the other hand, its independence is more limited than that of other expert boards because of its organizational position, especially in regard to its publicity function. The concept of counseling and advance planning formulated in a relatively broad way includes, basically, the whole range of potential activities which contribute to a continuous improvement in the rationality of decision-making of a policy oriented to the future. The extremities of this range are marked by ad hoc judgments on specific central day-to-day problems, and by systematic planning of longer-range programs. Despite the manifold forms in which political planning and scientific counseling in policy-making have already taken root in the German Federal Republic and other countries with similar political structures, the planning staff in the Chancellor's office is an institution *sui generis*, so that it has needed a certain time to reach an understanding of its own functions and role.<sup>29</sup>

These staffs at the head of the executive branch have the purpose of overcoming the limited perspective of specialists and of producing aids in making decisions from an overall viewpoint. The aim of the Chancellor's staff is to counteract narrow thinking in functionally oriented ministries. Such an overall perspective is vital for the head of the government. This fact must be taken into account in the organization and working methods of such staffs. Planning is in essence teamwork, which requires tight interdisciplinary cooperation and must differ in a typical way from the methods of other sub-departments in the Chancellor's office and in the ministries. It achieves its greatest efficiency not on the basis of quasi-hierarchical distribution of authority but only in a functionally organized, interdisciplinary team, whose members recognize a common responsibility and are not embedded in the categories of authority.

<sup>29</sup> Meanwhile planning staffs have also been set up in a number of ministries in the Bonn administration. It is not yet certain whether these boards have already found the approach required to cope with the tasks which they have been given and whether they are in a position technically (available data, financial possibilities to call in scientific advisors) and with regard to personnel (for example in the mastery of the techniques of prognosis and planning) to solve long-range planning problems. There is no general answer to the question whether certain aids in decision-making can be worked out better in individual cases by planning staffs, ad hoc commissions, or a department fitted into the line of organization. This depends on the specific tasks assigned to the ministries, on the functions which one wants to confer on the planning staffs, and on the methods by which they should work. In any case the problems of the planning staff in the office of the Federal Chancellor are in many respects of a special type and result above all from functions which the staff is to fulfill.

It is important that *vis-à-vis* the salaried planning group in the Chancellor's office, a circle of scientists from various disciplines should put themselves at the service of the Federal Government for definite advisory functions and work out patterns of action with the planning staff. At present the staff receives scientific counseling from a team of young scientists from various disciplines and, in addition, help from certain counseling institutions that have research contracts. The type of cooperation with the individual planning groups varies. In any case new paths of cooperation are being found between science and politics which still must prove themselves. In the conception of the Chancellor's advisory staff the plan is that members can always be exchanged; the table of organization is therefore very flexible. The circle of young scientists is also to have the task of creating and cultivating permanent contact with the universities. In its work the staff is to be free of day-to-day political pressures.

In the beginning, however, it became apparent that this was an ideal that could only be partly realized. At that time the team was always in the predicament of having to sacrifice longer-range work to find answers for the problems of the day.<sup>30</sup> Since then the group has turned primarily to long-range problems. It cooperates with—or in the Chancellor's office it serves—as the secretariat in working out proposals for fundamental reforms in the structures of government and administration. Two of the long-range functions of the staff are to develop concepts of new forms of cooperation between representatives of the State, science, and the economy and to work on fundamental questions in the areas of social policy.

The publication of proposals for establishment of this advisory staff has of course again aroused criticism from various opponents. They fundamentally oppose it because they consider it an attack on government power. The rebuttals as well as the critics' arguments disclose that they are still not completely clear about the relationship of scientific information, counseling, and decision-making, of planning and coordination. Especially is this true in the clarification of the relationship between theory and practice.<sup>31</sup> It is certain, though, that pluralistic society with its in-

<sup>30</sup> To a certain extent, however, the staff seems to have won influence so far over current political dealings precisely through reports for which the need has arisen from day-to-day politics. Thus the staff worked out a comprehensive paper on the renewal of diplomatic relations with Yugoslavia which does not seem to have been without influence on the Chancellor's decision. The team was also asked for advice during the discussions on European policy, on questions concerning an expedient form of federal-state cooperation, and on a number of other current issues.

<sup>31</sup> On this principal question see: K. Lompe, *Wissenschaftliche Beratung der Politik*, *op. cit.*, and "The Role of the Social Scientist in the Processes of Policy-Making," *op. cit.*

creasingly complex structure can no longer be governed by the prevailing methods of administration.

But the scientific advisory boards and planning staffs cannot replace politics in the classical sense and do not want to do so.<sup>32</sup> This applies to all forms of organization that have been discussed here. Scientific counseling does not destroy the subjugation of power to responsibility indispensable for democracy. But it can perhaps ensure that power will be used more meaningfully by the people entrusted with it. Cooperation on different levels between scientists and politicians and their critical discourse can open up new opportunities for democracy. If both sides observe the rules, this discourse itself can also have an important democratizing effect. It can possibly help to avoid the difficulty of opinion becoming entrenched and of thoughtless, ill-planned ad hoc measures taking the place of a policy based on well-thought-out programs and procedures.

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<sup>32</sup> It is apparent today that if one wants to realize planning in the interest of keeping or changing conditions in the future, he must be politically active in the classical sense and must advance his plan and himself to those positions where decisions are made. "And that is the reason why, contrary to expectations which nourish the vision of a technocracy, today the bureaucrats and planning experts to an increasing extent engage in politics instead of confidently waiting for politics to die painlessly away." (H. Lübke, "Rationalisierung der Politik," *Studium Generale*, Fasc. 8 (1968), p. 711.) On the other hand, however, long-range planning confronts democracy with the real risk of a politically irresponsible and unrestricted expertocracy on the part of the administrative planners. It was just as impossible to go into these problems in this article as it was to deal with the fundamental question of how long-range planning can be coupled with democratic norms.

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## The Prospect for Commercial Real Estate Under Land Value Taxation

By STEVEN CORD

### I

THE GREAT MAJORITY of homeowners would benefit from adjusting the present local real estate tax so as to switch the burden of taxation from improvements to land values. This is so because the average home owner has much more invested in his home than in the land under it. Thus, increasing the tax rate on the land and reducing it on improvements would result in a smaller annual tax payment for the average home owner. Most voters are home owners.

But a difficulty arises. How would a heavier land value tax affect commercial property owners; owners, that is, of store, office, apartment and factory buildings?

Stated briefly, shifting the tax from buildings to land would immediately benefit those land owners whose improvement-to-land-value ratio exceeds that of the city as a whole. For example, if, in a given city, improvements are double land values, then any land owner in that city whose improvement is more than double his land value would benefit if taxes were shifted from improvements to land values. (It is for this reason that such a tax is often referred to by urban renewal experts as an "incentive tax".)

Let's see how this principle would apply to apartment buildings. Because the improvement-to-land-value ratio of such property is generally quite high, there can be no doubt that most such landowners would receive an initial benefit in that their real estate taxes would be substantially reduced. But within a short time, the tenants in such apartment houses would also benefit: their rents could be expected to decrease markedly.

Why? Because the tax on improvements is passed on to apartment house tenants in the form of higher house rents. If this tax were reduced, so eventually would their rents be reduced. As for the increased tax on the land value, for once there is unanimity among economists: such a tax cannot be passed on to the tenant but must be paid by the land owner (their reasoning is that the price of land can be increased only if demand increases or the supply decreases—just as with anything else—but a tax on land cannot of itself increase demand or decrease supply).

One result of initial tax reductions to apartment house owners and even-

tual rent reductions to tenants will inevitably be a boom in new apartment house construction, a most desirable alleviation of the housing problem. It may not be possible for private enterprise to build low-rent apartment houses, but if the supply of apartment houses increases, there will be more older buildings for our poorer citizens to choose from, and hence they will be able to upgrade their housing accommodations.

Land value taxation would affect office buildings and factories in much the same way. In these cases, too, the improvement-to-land-value ratio is high, usually considerably higher than the city average, so the owners would receive initial tax reductions and the tenants would eventually receive rent reductions. If owner and tenant are one and the same (as is usually the case with factories), then the owner-user would receive both benefits. If a city is looking to attract new industry, what a wonderful inducement land value taxation would be! Potential industrial prospects could be promised lower taxes on the buildings they build or rent in town. Yet there would be no loss of revenue to the city treasury!

## II

IN THE DOWNTOWN retail areas, where location is best (and therefore land values and the taxes on them are highest), only the best developed retail properties will show immediate tax savings over the present tax system. But this is exactly where L.V.T. is needed the most, here in the usually blighted downtown areas where fabulous locations are poorly developed. With L.V.T., there would be no building tax to pass on to downtown merchants in the form of higher rents for their premises. *Nation's Cities* cites research showing that "untaxing improvements would make a much higher intensity of use profitable in the heart of the central business district. This would probably check the developing trend to central-business-district fragmentation and it might well double the profit potential in renewing old downtown neighborhoods and replacing, enlarging or modernizing buildings that are too old or too small for the valuable land they pre-empt."

Wouldn't downtown retailers benefit by having their customers living and working nearer them? Especially if their customers had some extra money to spend because their house taxes were lower? *In the long run, wouldn't the downtown land owners benefit also?* If urban blight is eating away at the core of our cities, it is because we penalize development there by taxing improvements and subsidize do-nothingism by low land taxes.

This question arises: "If the same amount of revenue is to be ob-

tained by a shift of taxation from building to land, then some people will benefit by paying lower taxes and others will suffer by having to pay higher taxes. So why bother? The tax losses counter the tax gains; where is the net benefit?" A searching question, but note that under L.V.T., tax reductions are geared to enterprise. The more a land owner improves his land, the greater will be his tax saving compared to the present real estate tax. The more he beautifies the city by improving his property and the more he benefits the city by providing much-needed housing, the more his tax saving would be. Instead of taxing office and factory buildings, L.V.T. would untax them, thus creating new jobs and opportunities. Is there any wonder, then, that this tax is called the "incentive tax"? Instead of hindering incentive, it harnesses it!

And there are other benefits. By imposing a penalty on the under-use of land, by increasing the tax burden on those land owners who have insufficiently improved their land, we force land to be efficiently used. Who could keep land out of use or in only partial use, if his land were taxed according to its value? Should not our tax system reward efficiency and penalize inefficiency? If it doesn't do that, we shouldn't be surprised that slums and other urban evils abound; slums, the worst of which are overcrowded inadequate improvements on valuable central-city land. L.V.T. would force these owners to improve their valuable land (or sell out to someone who would) by taxing the land more heavily, while at the same time it would make it easier for them to do by untaxing the improvements they make. Certainly there is a difference between a tax that encourages incentive and one that allows inefficiency.

Impose a heavy but well-balanced load on a camel and he will manage well enough. But take the same load and put it too much on one side or the other, and the camel will barely be able to crawl along.

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# The Economics of the Numbers Game

By LAWRENCE J. KAPLAN and JAMES M. MAHER

## Introduction

THE PROBLEMS THAT EXIST in the underprivileged areas of the nation have been studied and analyzed by social scientists in the hope that understanding their background may help supply some solutions. All too often, however, the analysis reveals a chain of events that proves difficult, though not impossible, to follow. One of the problems that falls into this category, a product of the hopelessness and emptiness prevalent in the lives of people living in the slums, is that of illegal gambling. The purpose of this article is to analyze just one aspect of that problem: the economics of the numbers game.

Millions of dollars of federal money are poured into urban areas to be spent on welfare, employment, and training. In turn, the poor divert millions from their incomes into illegal gambling, primarily into the numbers game; into the purchase of narcotics; and into paying exorbitant interest rates to loansharks. Directing and controlling all these activities is the organized criminal syndicate. If America is concerned with poverty, then it must also be concerned with organized crime for the urban poor are the principal victims of it. Indeed, organized crime is the major beneficiary of the misery of the slums.

Today, the primary source of funds for organized crime is through illegal gambling. Gambling profits finance the other major interests of organized crime, including narcotics, prostitution, loansharking, bootlegging, and labor racketeering. The most popular form of illegal gambling is the numbers game, which, with its lure of a possible 600-to-1 payoff, has surpassed horse race betting and other gambling activities.

## I

### Organized Crime in the Gambling Business

THE PRESIDENT'S COMMISSION on Law Enforcement and Administration of Justice defines organized crime as

. . . a society that seeks to operate outside the control of the American people and their governments. It involves thousands of criminals, working within structures as complex as those of any large corporation, subject to laws more rigidly enforced than those of legitimate governments. Its actions are not impulsive but rather the result of intricate conspiracies, carried on over many years and aimed at gaining control over whole fields

of activity in order to amass huge profits.<sup>1</sup>

The President's Crime Commission and the Kefauver Committee, which reported its findings in 1951, are in agreement that organized crime—also known as the crime syndicate, the Mafia, or Cosa Nostra—controls almost all of the illegal gambling in the United States.<sup>2</sup> Since basic statistics on the magnitude of the illegal gambling business, by their very nature, are not knowable, it is necessary to make estimates, using the few sources available.

A widely used estimate of organized crime's annual gross revenue from gambling is \$20 billion a year, of which the major portion comes from wagers in the numbers game.<sup>3</sup> Evidence gleaned by the President's Crime Commission indicates that organized crime's profit from gambling alone runs as high as one-third of gross revenue, or \$6 or \$7 billion a year, about a 35 per cent return. This annual profit is equivalent to the total profit of the 12 largest industrial corporations in the United States in 1966 ranked according to sales. These 12 companies had sales of \$86.3 billion in 1966 in order to earn their \$7 billion profit, about an 8 per cent return based upon sales.<sup>4</sup>

The underworld is gradually finding its way into the upperworld. The leaders of the syndicate understand well a basic law of economics. Money is worth nothing unless it is put to work. And so, the millions, perhaps billions, of dollars which are shipped to Swiss banks for safekeeping or which are hidden privately in the United States ultimately are invested in many sectors of our economy. The "dirty" money of the syndicate thus becomes clean. Examples of legitimate businesses which are being infiltrated by the syndicate include: bakeries, motels, night clubs, trucking companies, laundries, service stations, catering establishments, jukebox and vending machine businesses and meat wholesaling.<sup>5</sup>

A common characteristic of these businesses is that they involve heavy flows of cash.

The Syndicate tends to choose cash businesses to invest in, to win room

<sup>1</sup> President's Commission on Law Enforcement and Administration of Justice, *The Challenge of Crime in a Free Society*, Washington, D.C.: U.S. Government Printing Office, 1967, p. 187.

<sup>2</sup> United States Senate, Special Senate Committee to Investigate Organized Crime in Interstate Commerce (the Kefauver Committee), *Final Report*, 82nd Congress, 1st Session, Report No. 725 (1951), p. 88.

<sup>3</sup> Based upon ranges suggested in the Crime Commission's report.

<sup>4</sup> The *Fortune* Directory, *The 500 Largest U.S. Industrial Corporations*, published by *Fortune Magazine*, June 15, 1967.

<sup>5</sup> Sandy Smith, "Mobsters in the Marketplace: Money, Muscle, Murder," *Life Magazine*, Vol. 63, No. 10 (September 8, 1967).

for maneuver in reporting income for tax returns.<sup>6</sup>

But, the Syndicate also chooses businesses that complement other activities. For example, Syndicate bosses go into plastic manufacturing which gives them access to chemicals used in converting raw opium into heroin, another illicit operation.<sup>7</sup>

The legitimate business ventures often turn out to be convenient adjuncts for the racket.

The junkyard may contain an auto-crushing machine through which they pass an automobile containing a disobedient gang member which flattens both into what looks like a thick piece of dirty metal; the garage may turn out to be a paint shop for hot cars; and the print shop may do church programs at a discount, but it may also turn out tally sheets for the operation of the numbers bank.<sup>8</sup>

Organized crime finds the numbers game the ideal criminal activity, and the reasons are easy to understand. A former New York City Police Commissioner states the case succinctly:

The numbers game is easily organized; it is popular with the public; there is a guaranteed, built-in margin of profit; detection, because of the protection and security offered by the laws of search and seizure, and by recent court decisions, is difficult; and punishment is mild and hardly a deterrent.<sup>9</sup>

## II

### Historical Background

THE NUMBERS GAME is probably a variation of the Italian National Lottery which was started in 1530, and is still operating.<sup>10</sup> This lottery is based upon a selection of numbers from one to 90 coupled with the selection of one of 10 Italian provinces where the drawings are held. Unlike the numbers game, the lottery is a once a week operation.<sup>11</sup> The Italian lottery is not too different from the numbers game as it is known in the United States.<sup>12</sup>

The origin of the numbers game may also be traced to the London Lottery shops during the first half of the 18th century. They sold an

<sup>6</sup> Bernadette Carey, "Two Bit Bet: Financing a Crime Empire," *Look*, Dec. 14, 1965, pp. 131-2.

<sup>7</sup> *Ibid.*

<sup>8</sup> Fred Powladge, "Pick a Number from 000 to 999," *New York Times Magazine*, Dec. 6, 1964, p. 156.

<sup>9</sup> A statement by Michael J. Murphy, a former Commissioner of the New York City Police Department, quoted by Charles Grutzner, "Survey on the Operation and Organization of Policy," *New York Times*, June 26, 1964, p. 17.

<sup>10</sup> John Scarne, *Scarne's Complete Guide to Gambling* (New York: Simon and Schuster, 1961), p. 164.

<sup>11</sup> John Drzazga, *Wheels of Fortune* (Springfield, Ill.: Charles C Thomas, 1963), p. 150.

<sup>12</sup> Charles Grutzner, *op. cit.*, p. 17.

insurance or policy ticket which brought gambling within reach of those who could not afford to purchase a lottery ticket. For a small sum, a player selected one or more numbers which he believed would appear on the winning lottery ticket. The amount of his winnings was predicated on odds that were quoted for the number of correct choices.<sup>13</sup> In point of similarity it would appear that the London Lottery was the direct forbear of the numbers game as we know it today.

In the United States, through the colonial period, the numbers game was similar in its operation to the London Lottery. But, the reputation of the game was low. In 1819, a Committee on Lotteries in New York City, after a study of that city's 60 lottery shops, discovered various types of fraud, particularly manipulation of winning numbers.<sup>14</sup> As time elapsed, one state after another legislated these lottery shops out of business.

At this point, the numbers game began to operate and it was dominated by groups who made enduring alliances with the political groups of the era. The game was big business, profits were large, and it gradually expanded to 20 other cities across the young nation. The "Policy Kings," as they were called, increased the moneymaking possibilities of the game by insuring that only numbers that were not played, won. Some of the operators were finally jailed and by 1915, the 19th century numbers game was no longer an important part of the scene in the United States.<sup>14</sup>

The idea of the numbers game, however, was not dead. In 1921 a group of Negro lottery salesmen selling treasury tickets, a form of lottery, added a policy ticket, and the game was started up again.<sup>15</sup>

Organized crime became interested in the numbers game when Prohibition was voted out. Bootlegging was no longer profitable and the personnel and capital of the underworld sought greener pastures.

Dutch Schultz [Arthur Flegenheimer] was the first white hoodlum to discover that there were huge profits to be earned in the ghettos through the numbers game. At the time he was a bootlegger. He finally moved in and took it over. The Syndicate exiled him to New Jersey, later had him executed, and has been operating the game ever since.<sup>16</sup>

The numbers game is also known as "policy." The term "policy" first came into American usage around 1885. It was derived from the Italian

<sup>13</sup> Herbert Asbury, *Sucker's Progress* (New York: Dodd, Mead, & Co., 1938), pp. 89-90.

<sup>14</sup> *Ibid.*, pp. 90, 156.

<sup>15</sup> John Scarne, *op. cit.*, pp. 168-71.

<sup>16</sup> Bernadette Carey, *op. cit.*, p. 134.

word *polizza* which means voucher or receipt.<sup>17</sup> Another view of the origin of the term is the following:

Policy is a form of lottery usually based on horse-racing results. The name derives from its earliest days, when poor people used for betting money the nickels and dimes saved to pay insurance-policy premiums.<sup>18</sup>

### III

#### Operation of the Numbers Game

*The game:* A numbers player selects three digits from 000 to 999. Between 000 to 999 are 1,000 three-digit numbers, and only one of them wins. The various forms of play are termed:

- a. Straight (three digits)
- b. Combination (of any three digits)
- c. Front bolita or boleda (first two digits)
- d. Back bolita or boleda (last two digits)
- e. Single action (any one digit)<sup>19</sup>

a. *The straight bet* is one on any three-digit number; for example, 753. The chances or probability of winning are 1 in 1,000, or the odds are 999 to 1 against the player. Each player has an equal chance of winning, and the odds remain the same every day. The payoff odds are 600-to-1 generally.

b. *The combination bet* increases the probability of winning. The player is betting on all arrangements of the three-digit number, which is known as a six-way combination. For example, if the number is 753, the bet is on all six of the following: 753, 735, 573, 537, and 375. This reduces the payoff to one-sixth so that the 600-to-1 payoff is reduced to 100-to-1.

c. *The front bolita or boleda bet* is one in which the player selects a two-digit number, for the first two of the three digits. For example, the player selects 75, 7 for the first slot and 5 for the second, as follows:

7	5	X
---	---	---

In this type of bet, the payoff is 60-to-1. Variations exist among the different games.

d. *The back bolita or boleda bet* is one in which the player is betting

<sup>17</sup> D. Wakefield, "Harlem's Magic Numbers," *Reporter*, Feb. 4, 1960, p. 25.

<sup>18</sup> Bernadette Carey, *op. cit.*, p. 134.

<sup>19</sup> Frederick W. Egan, *Plainclothesman* (New York: Greenberg, 1952), pp. 66-70.

only on the middle and last numbers. For example, he may bet 53 in the following manner:

X	5	3
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The payoff odds are the same as in the *front bolita* or *boleda bet*, 60-to-1, with possible variations among the different games.

e. *The single action bet* is one in which a "bank" permits a player to bet on a single digit in any one of the slots. For example, the bettor may wager that a 7 will appear in the first, second, or third slots:

7	X	X
---	---	---

       or     
 

X	7	X
---	---	---

       or     
 

X	X	7
---	---	---

On *the single action bets*, the payoff is 6, 7, or 8 to 1, depending upon the bank.

*The odds:* On a straight bet, the chances of winning are 1 in 1,000, or the odds are 999 to 1 against the player. While the payoff odds are 600-to-1 generally, in some games the odds are 550-to-1, 500-to-1, or even 450-to-1. For example, lower odds prevail in Brooklyn than in other boroughs of New York City, because the Syndicate is more tightly operated there.<sup>20</sup>

*Popular numbers:* Some examples of popular numbers are 111, 125, 222, 711, or 325 in various combinations. There are other popular numbers.

Payoffs on these numbers is less, so that a bank does not get hit too hard. The popularity of certain numbers may be attributed to superstition.<sup>21</sup> Some numbers represent life, some death, some sudden wealth, and some are derived by observing the license number of a passing car. Payoff odds are lower, possibly 500-to-1 or 450-to-1, depending upon the game's operators. The lower odds seek to discourage widespread play on them, and possible ruin of the "bank" if the number should win for the day.

Some game operators depend upon a "layoff" system to reduce the pressure of heavy betting on a particular number. Usually, the Syndicate stands ready to support a particular numbers game operation.<sup>22</sup> The "banker" pays a premium for this service but the layoff system insures the business by preventing bankruptcy if a number with a large play wins.<sup>22</sup>

*Size of bets:* Bets used to be pennies and nickels. In today's affluent society, a quarter is generally considered a minimum bet. Typical players

<sup>20</sup> Fred Powledge, *op. cit.*, p. 147.

<sup>21</sup> Anthony Scaduto, "The Bob: A New Look," *New York Post*, June 7, 1968, p. 42.

<sup>22</sup> John Drzazga, *op. cit.*, p. 143.

bet 50 cents or a dollar. Middle income players are joining the fun with \$5 and \$10 bets, and even more.

In Manhattan, straight play is the usual method, and is often called New York policy.<sup>23</sup>

*Placing a bet:* The seller of bets usually has a piece of paper on which he records the number selected by the bettor, the amount of the bet, and identifying initial of the bettor, as follows: 753—50¢. J. The amount of recorded information is a minimum. No receipt is given to the player.

In some locations and in some cities where the pressure of law enforcement officers is not too great, additional paperwork may be involved. The seller of bets may carry a small paper pad about half the size of a bank check. Each bet is recorded on the first sheet which has two carbon copies underneath.

The collector takes the 50 cents, tears off the top sheet, and gives it to the bettor. The two carbon copies remain in the pad. The seller retains one copy and turns the money and second copy over to the pick-up man.<sup>24</sup>

*Payoffs:* If a player makes a *bit* on a *straight bet*, he is paid at the 600-to-1 odds, but receives only 540-to-1. If the player had bet \$1, he gets \$540, not \$600, because the collector, who pays off the winner, retains 10 per cent, or \$60, as his tip or commission.

Another element of the game which is a hazard to the potential winner, is the rule: *Not responsible for arrested work*. If the collector is arrested, and the records are either destroyed, lost, or taken into custody by the police, no payoffs are made to the unlucky players.

*Determining the winning number:* The numbers game depends upon the payoff odds used to pay winning bettors at the local horse racing track. Usually, a particular track is designated for the determination of the winning number. These odds are determined by the pari-mutuel machine. While variations exist, it has been estimated that 95 per cent of numbers game operators derive the winning number from pari-mutuel race results, also known as the *Manhattan way* for computing the winning number.<sup>25</sup>

To compute the three digits which make up the winning number for the day, the following system is used.

For the first number, the six money winnings figures, or *mutuels*, for each of the first three races are added together. That is, the amounts that \$2 bets would have won are summed. These bets cover the one horse that won, the two which placed and the three which showed. The

<sup>23</sup> Fred Powlage, *op. cit.*, p. 35 ff.

<sup>24</sup> John Scarne, *op. cit.*, p. 177.

<sup>25</sup> Charles Grutzner, *op. cit.*, p. 17.

last digit to the left of the decimal in the total is taken as the first digit of the Manhattan Number. Similar operations for the first five races give the middle digit and for the first seven races the third digit. The eighth and ninth races do not figure in the determination.<sup>26</sup>

A less complex method also used is called the Brooklyn number. It is derived from the pari-mutuel handle of the day (the total amount of money bet at the track that day). The three numbers to the left of the decimal is the winning number. For example, on June 17, 1968 the pari-mutuel handle was \$2,614,790. The Brooklyn number for the day was 790.<sup>27</sup>

Generally, the game's operators accept bets on the Manhattan number. Some operators, however, will accept bets on the Brooklyn number if the player specifies this when placing his bet.

Some numbers players find the need for additional action after the first number becomes available. The operators fulfill this additional service. When the trotting races are in season, a second three-digit number is figured in the same manner as the Manhattan number, but based upon the pari-mutuel results from the trotting tracks. Because the results are not known until late at night, it is called the night number.<sup>28</sup>

Other systems are available for computing winning numbers:

A few banks, chiefly in East Harlem, take play also on the number that comes up in the legal weekly lottery in Puerto Rico. In Italian neighborhoods, there is still some play on numbers in the daily treasury reports of 10 provinces in Italy. There is even a Chinese policy game, based on daily drawings in Chinatown, which involves colors as well as numbers.<sup>29</sup>

Most numbers players, prefer the *Manhattan way* for computing the winning number, because it employs a randomizing process based upon the laws of chance, and is thus secure from human manipulation.

#### IV

##### Economic Aspects of the Numbers Game

OF AN ESTIMATED ANNUAL GROSS gambling revenue of \$20 billion, the authors figure there is a national numbers game handle of between \$10 and \$12 billion a year. This is big business! In New York City alone it is believed that the numbers game grosses two million dollars a day.<sup>30</sup> Another estimate for New York City states that:

<sup>26</sup> John Scarne, *op. cit.*, p. 171.

<sup>27</sup> Charles Grutzner, *op. cit.*, p. 17.

<sup>28</sup> *Ibid.*

<sup>29</sup> *Ibid.*

<sup>30</sup> John Scarne, *op. cit.*, p. 177.

More than 500,000 daily players pour at least \$200 million a year into this city's policy banks.<sup>31</sup>

Exact figures on the operation are not available. However, the amount is so huge that, even allowing for error, the number of players and the amount of money involved in the numbers game are tremendous. To operate a big business requires careful management, efficient organization, and an alert group of specialists.<sup>32</sup>

*Organization of the numbers business:* The numbers game business begins with the player who wishes to place a bet. He represents a foundation block in a giant pyramid. The individual who accepts the bet is the *collector*. In the larger banks he is usually a full-time employee, and in the hierarchy is at the bottom level of the numbers game business. In smaller operations, the *collector* may be a storekeeper, a newsstand operator, an elevator operator, a barmaid, a pizza seller, or a fellow-employee in a plant or company, and works in the numbers business as a part-time employee to supplement his income.

On the level above is the *controller*. He operates as a branch manager or area manager. He is responsible for tabulating daily collections, maintaining the records of a large number of *collectors*, and making payoffs with money from the bank. A *controller* may operate out of an apartment or a private house. The location is changed hourly or daily in order to avoid detection. The place is referred to as a *drop*, because this is where the pick-up men drop off their money and slips. Thousands of these *drops* are in operation in a large metropolitan area.

At the top of the pyramid is the *bank*. Often referred to as the *Big Drop*, it is the headquarters which collects the daily receipts of the various *controllers*. The *bank* operator is referred to as *banker*. In this capacity he serves as the administrative head of the operation. The authorities estimate that between 15 and 20 banks operate in New York City.<sup>33</sup> One numbers game operation, headed by a bank, may employ as many as 400 people, which includes about 300 collectors. Payoff money is paid by the *bank* to the *controllers* who in turn pass it on to the *collectors* who in turn make the payoffs to the winners. The *banker* manages the operation, hires the specialists and workers, and determines the area where they will work.<sup>34</sup>

The *banker* reports to a member of the Syndicate who probably never

<sup>31</sup> Charles Gratzer, *op. cit.*, p. 1.

<sup>32</sup> "Bigness and Badness," *Time*, Jan. 13, 1967, p. 64.

<sup>33</sup> Fred Powledge, *op. cit.*, p. 147.

<sup>34</sup> Thorsten Sellen, "Organized Crime: A Business Enterprise," *Annals*, Vol. 346 (May 1963), p. 7.

sets foot in the *bank* which is only one of his many enterprises. The overlords of the numbers game

. . . are mixed up in every sort of illegitimate activity and vice. Its profits are used to finance traffic in dope, abortion rings, loansharking, prostitution, extortion, hijacking, smuggling, and murder.<sup>35</sup>

Organized crime is firmly entrenched in the numbers game. Several of the overlords

. . . are retired practitioners of violent ventures, who have invested in the numbers racket some of the money amassed from bloodier enterprises.<sup>36</sup>

A *pick-up man* operates as liaison between the *collectors* and the *controllers*. A different *pick-up man* operates between *controllers* and the *bank*. Generally, the money and betting records travel different routes to prevent total loss and to reduce evidence available to police in case of arrest. The *pick-up man* is salaried. Other staff members include lookouts, tabulating machine operators, bookkeepers, bail bondsmen, accountants, and lawyers.<sup>37</sup> Accountants, lawyers, and bail bondsmen perform their normal professional services to maintain an efficient operation.

The entire operation, while well organized, is decentralized to prevent disruption by the police. The lookout man may spot a law enforcement officer and warn a collector but this is not always possible. However, in addition to employing lookouts, the operators of the game pay graft to police officers to allay arrest or for promising that they will be tipped off if a raid were planned.<sup>38</sup>

The employees in the numbers game know that if they are arrested, the bail bondsman and attorney of the Syndicate will be down to get them out. If they are convicted, fines may be imposed, but jail terms are short.<sup>39</sup>

*Division of the proceeds of the game:* *Collectors* receive commissions on the numbers they bring in from players. Commissions are 25 per cent, and if the collector desires to make a personal bet of a dollar, he gets the dollar bet for 75 cents. If a collector takes in \$100 a day in bets, he turns over \$75 to the controller and keeps \$25.

The *controller*, after rounding up all the bets from the collectors, deducts 10 per cent for himself as commission. He then turns the money and the slips over to the bank.

The *bank* receives 65 per cent of the money wagered. Out of this, the bank pays off the hits as well as the overhead of the operation including

<sup>35</sup> Bernadette Carey, *op. cit.*, p. 132.

<sup>36</sup> Charles Grutzner, *op. cit.*, p. 17.

<sup>37</sup> *Ibid.*

<sup>38</sup> *Ibid.*

<sup>39</sup> Fred Powledge, *op. cit.*, p. 156.

rent, graft, salaries to inside workers, bail bondsmen, lawyers and accountants.<sup>40</sup> The bank's lawyer is responsible for springing arrested collectors and pick-up men. Incidental expenditures of the bank include handouts to hard-up players; entertaining players, collectors, and pick-up men at bars and restaurants; and contributions to charities.<sup>41</sup>

The profit which goes to the member of the Syndicate who owns the game is estimated at between 5 and 15 per cent.<sup>42</sup> If the New York City gross is estimated at \$200 million a year, then the profit is \$10 to \$30 million a year. If the national numbers game handle is estimated at \$10 to \$12 billion a year, a 5 to 15 per cent profit would yield between \$500 million to \$1.8 billion to organized crime from this single enterprise.

*Employment and earnings:* The numbers game is a major factor in the economics of ghettos all over the country.<sup>43</sup> Employment opportunities for the unskilled Negro in a ghetto are either limited or not available. The numbers game offers a poor boy the opportunity to earn a livelihood. He could start as a collector. If he knew some arithmetic and could operate an adding machine, he could be a controller. And if he had some administrative skill, perhaps he could be a banker. In the words of a numbers game operator in Harlem:

Harlem was the place with the heaviest concentration of numbers players. . . . Numbers is a way of life in Harlem and many, many people there make their living this way.<sup>44</sup>

One estimate for numbers game employment in New York City is 10,000 jobs.<sup>45</sup> Another estimate places the number of jobs at 100,000.<sup>46</sup> The true figure probably lies somewhere in-between but thousands of people earn their livelihood in the numbers game. An end to the numbers game would certainly mean a wave of unemployment.

Earnings estimates of the various classifications of personnel vary. Collectors have the largest proportion of jobs in the operation of the game. Collectors' incomes range from about \$50 to \$200 a week depending on the season (holidays are best); on the amount of regular trade built up; and on whether they are part-time or full-time on the job.<sup>47</sup> In a Ford

<sup>40</sup> D. Wakefield, *op. cit.*, pp. 25-6.

<sup>41</sup> John Scarne, *op. cit.*, p. 178.

<sup>42</sup> Fred Powledge, *op. cit.*, p. 147.

<sup>43</sup> Bernadette Carey, *op. cit.*, p. 134.

<sup>44</sup> Quoted by Jack Roth, "Gamblers Operate Numbers Game in Open," *New York Times*, May 7, 1967, p. 80.

<sup>45</sup> D. Wakefield, *op. cit.*, p. 25.

<sup>46</sup> John Scarne, *op. cit.*, p. 172.

<sup>47</sup> D. Wakefield, *op. cit.*, p. 25.

plant in Detroit, a \$100 a week employee earned another \$1,000 a week soliciting numbers bets.<sup>48</sup>

The wife of a Syndicate leader who ran a numbers bank for her husband testified at a separation hearing that her husband drew between \$1 million and \$2 million a year out of it. She spoke freely about her husband's interests in narcotics, liquor, extortion, night clubs, and dog tracks he owned.<sup>49</sup>

One student of the operation in Harlem estimated that the criminal syndicate takes out \$300,000 a week, or more than \$15 million a year.<sup>50</sup> Another estimate places the money-flow out of Harlem into the Syndicate as a result of the numbers game at \$1 million a week.<sup>51</sup> Certainly, some part of the poverty of the slums is the result of an unfavorable balance of payments with more money leaving than coming in. The source of these monies is salaries, pensions, and relief checks of slum-dwellers.

Lone operators of the game who die suddenly leave huge sums of cash. In February 1964, an effort to total a decedent's cash took shifts of officers 20 hours. They finally arrived at a figure of \$763,233.30! In Jersey City, N.J. a few years ago, \$2,400,000 in cash was found in the trunk of a car. After long debates on how to dispose of this money, in July 1965 it was decided to turn it over to the Internal Revenue Service.<sup>52</sup>

An estimate of the division of the national numbers handle is as follows:<sup>53</sup>

<i>Item</i>	<i>Per cent</i>
Prize money to players	54
Salaries and operating expenses	36
Graft for politicians and police	5
Profit	5
Total	100

Taxes to the federal and state governments on the billions involved in the numbers game are zero.

## V

### Evaluation of the Numbers Operation

SEVERAL BASIC IDEAS must be considered in evaluating the numbers operation:

<sup>48</sup> John Scarne, *op. cit.*, p. 173.

<sup>49</sup> *Ibid.*, p. 42.

<sup>50</sup> Thomas A. Johnson, "Legality is Urged for Numbers Play," *New York Times*, Dec. 18, 1966.

<sup>51</sup> Bernadette Carey, *op. cit.*, p. 134.

<sup>52</sup> Bernadette Carey, *op. cit.*, p. 132.

<sup>53</sup> John Scarne, *op. cit.*, p. 165.

1. Illegal gambling flourishes because the *good* citizens support these activities. The national attitude has not changed since Prohibition days when the demand for liquor was supplied illegally.

Even though the numbers game is illegal in every state, including Nevada, the individual who wants to bet can always find a collector. In New York State, it is illegal to *accept* bets, but not to place bets.<sup>54</sup>

2. The billions of dollars generated by the numbers game and controlled by the Syndicate are bypassing the nation's tax flows and legitimate channels of investment. The members of the Syndicate and the employees of the game who receive their wages and salaries from this illegal source do not report such income, and pay no income taxes, thus increasing their relative incomes and decreasing government revenues, making taxes higher for income-earners in legitimate activities.

3. A significant share of numbers game money is used to bribe dishonest policemen and dishonest politicians. This corruption and compromise of the principles of clean government destroys respect for law and order, encourages juvenile delinquency, and undermines the foundations of our democracy.

4. Enforcement of laws against illegal gambling, particularly the numbers game, requires large expenditures of public funds. Hundreds of policemen are required daily to combat the game. To this cost must be added the costs of police supervisors, administrative costs of city, state, and federal agencies concerned with this problem, court costs to prosecute offenders, and costs for incarceration when required. Government costs amount to tens of millions of dollars in a venture which is not entirely successful.

5. The operators of the numbers game use the tremendous profits for other criminal activities. The cash generated by this illegal game finds its way into many other illegal activities including narcotics and loan-sharking. In addition, the huge earnings are infiltrating legitimate businesses which, like contracting, could still result in cheating the public. For example, inferior materials may be used. Some syndicate truckers are known to have eliminated competition and then raised rates.

6. The numbers game has been legislated against as an evil. As such, this interpretation is contrary to the desires and beliefs of the people who play the game. It is a conflict between what man is and what some people believe he ought to be.

<sup>54</sup> State of New York, *Revised Penal Law*, "Gambling Offenses," Article 225, pp. 127-29, effective Sept. 1, 1967.

The attitude of the poor people who participate in this daily source of hope may be summed up in the following:

Nobody bothers about the rich racetrack guys or the big shots who play the stock market. They call them sportsmen and financiers. They are *society*. When we bet on something, we're criminals.<sup>55</sup>

7. The thousands and thousands of ordinary, decent people who play the numbers game are often unaware and unconcerned that the bets they place support a Syndicate consisting of some of the worst elements in American society. The average American is amused by the existence of the underworld, and does not think of it as a blemish on American culture.

The President of the National Council on Crime and Delinquency pointed out recently that if we retain the anti-gambling laws

. . . organized crime will, in ten or fifteen years, amass at least one-half a trillion dollars.<sup>56</sup>

A U.S. Justice Department attorney stated:

All the country's rackets are organized. They are run by Syndicates . . . the top criminals in the country who have some agreement as to territory. They are connected. They cooperate with each other in carrying on their illegal activities and unify against forces of the law. Policy helps finance it all.<sup>57</sup>

*Status of gambling in the United States:* New York State and about twenty-five other states have legalized pari-mutuel betting at racetracks. New York State voters approved pari-mutuel betting at racetracks in November 1939.

New York State and some other states have legalized bingo, while some states tolerate the game even though it is illegal under anti-lottery laws. The voters of New York State approved bingo games in November 1957 for

. . . religious, charitable, and similar non-profit organizations.

Two states have legalized lotteries to raise revenues for educational needs, New Hampshire since 1964, and New York since June 1967 after approval by the voters in November 1966.

In New York State, in addition to current efforts to legalize off-track betting, an Assemblyman from Harlem, Charles Rangel, proposed a bill in the state Legislature which would authorize a study of the feasibility of legalizing the numbers game. The Assemblyman claims that legalization would, first, stop what he calls police-criminal collusion in slum areas,

<sup>55</sup> Quoted by Bernadette Carey, *op. cit.*, p. 134.

<sup>56</sup> Carl M. Loeb, Jr., "Anti-Gambling Laws Opposed," (Letters to Editor), *New York Times*, July 14, 1968.

<sup>57</sup> Quoted in Bernadette Carey, *op. cit.*, p. 134.

and, second, provide needed revenue for community improvement. Mr. Rangel said:

. . . the profits could be made to work for the good of the community in hospitals, for nursing homes, and educational centers.<sup>58</sup>

Several gambling laws were approved in New York State by the 1970 session of the Legislature and signed by Governor Nelson Rockefeller.

1. New York State's 1966 lottery law was amended to stimulate lagging sales. The amendments permit the state to operate the lottery more frequently than once a month; to increase the prize pool; to reduce the \$1 ticket price to as low as 25 cents; to sell tickets through vending machines; and to permit sales of lottery tickets in bars and liquor stores.

2. In another action, New York State legalized off-track betting. Two laws were approved. One creates the New York State Off-Track Pari-Mutuel Betting Commission whose function is to regulate the local option plans of participating municipalities, or to directly operate the local plan through its own employees and facilities if a municipality requests it. The law requires a referendum in localities planning to set up the betting system. Since a November 1963 referendum in New York City approved the principle of legalizing off-track betting by a 3 to 1 margin, New York City is allowed to proceed with its plans without conducting a new vote.

The second off-track betting law creates a public benefit corporation known as the New York City Off-Track Betting Corporation to be administered by a board of directors consisting of five members appointed by the Mayor. In early July Mayor John Lindsay appointed Howard J. Samuels as chairman of the city's new Corporation and named the four other members. These positions are unsalaried. The Corporation planned to open at least 1,000 off-track betting windows in 100 wagering parlors within a year. Wagers accepted from patrons are recorded and transmitted by computers to the pari-mutuel pools at harness and flat tracks in New York State as well as at some tracks outside New York State.

Revenues for both the state and city will be derived from a 17 per cent tax on harness track bets and a 16 per cent tax on thoroughbred track bets. The city will receive 80 per cent of the tax money and the state 20 per cent. When the city's revenues go over \$200 million, the split will be 50-50.

3. Another law established a New York State Quarter Horse Racing Commission which has been authorized to set up pari-mutuel betting at licensed quarter horse race meetings. Quarter horses are a cross between the American mustang and the thoroughbreds. They are well-known for

<sup>58</sup> Thomas A. Johnson, *op. cit.*

their ability to run a quarter-mile at high speed, 21 or 22 seconds. Quarter horse races are held on a quarter-mile straightaway.

A spot check of players, collectors, and policemen has resulted in a consensus that the illegal numbers game will remain unaffected by the state's latest efforts. Those individuals who play the numbers game apparently are seeking daily action at low cost; enjoy the convenience of having the collector seek out the player to pick up the daily bet; and prefer the non-taxable nature of winnings.

*Status of gambling in other countries:* France, Britain, Sweden, other European countries, Australia, New Zealand, and Puerto Rico have government-operated gambling services. Some have lotteries that are very similar to the numbers game. In France, for example, a system of off-track betting, called *Tierce*, was initiated in 1954. Bettors must pick the win, place and show horses in a designated Sunday race at one of the French tracks. Bets are placed in government-operated off-track parimutuel booths. In 1966, the French spent \$680 million on *Tierce* of which the French Treasury's share was \$160 million. The earnings of *Tierce* are equal to two-thirds of the earnings of the Renault automobile works, indicating the popularity of the game with the average Frenchman.<sup>59</sup>

The statement of the head of the French lottery is relevant. He says: Traditional morality condemns gambling. It is not the function of the State to exploit its citizens' taste for gambling. But on a practical level, a State which prohibits gambling will see it taken over by organized crime. Thus, the State is forced to control and participate in this most culpable form of gain.<sup>60</sup>

## VI

### Conclusions and Recommendations

#### *Conclusions*

1. In the last analysis, gambling thrives because a large proportion of people enjoys betting of all kinds. These people see no harm in gambling, and do not regard it as immoral even though our society has declared it illegal. As long as this attitude prevails, and there is no reason to expect it to change, effective enforcement of anti-gambling laws is impossible.

2. Government operation of gambling would make a significant inroad into the economic resources of organized crime. The government's entry into gambling would cut the Syndicate's profits which today are unreported and therefore untaxed.

<sup>59</sup> Sanche de Gramont, "How to Play a Lottery," *New York Times Magazine*, May 7, 1967.

<sup>60</sup> *Ibid.*

3. Anti-gambling laws and their resultant, organized crime, have created a major source of bribery, political corruption, and evasion of law.

4. Government operation of gambling would pose many new technical and administrative problems, but these must be isolated and solved, since today's illegal gambling in our nation is not being successfully curtailed.

### *Recommendation*

Government should organize and operate the numbers game as a public service, and should compete with the Syndicate by offering better odds. If the odds of the game are 600-to-1 for a straight number, the government should offer 750-to-1. The profits of the operation could be used to provide a variety of projects and services in the nation's slums which provide the primary source of income for the game. While government operation and control may eliminate a significant portion of corruption, it may bring in its wake a host of new problems.

Perhaps a thorough study and evaluation of foreign experience could help to pinpoint the problems and discover those areas of operation which may be adjusted to fit American requirements.

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## Tax-Induced Slow Turnover of Capital, IV

By MASON GAFFNEY

### V

#### Land

WE HAVE ANALYZED three classes of durable capital assets: appreciating, full salvage, and depreciating. Finally we come to the fourth and last, land. Land differs so much from the first three that many economists regard it as a class *sui generis*, and so do we, but the reader may prefer his own taxonomy and still note with us that land yields income in perpetuity; land purchase is not income-creating, macro-economically speaking; land never turns over in the Austrian sense of production and liquidation; land is immobile among taxing jurisdictions; land is periodically salvaged by demolition of old buildings and renewed with new ones; land grades off from the best down to a marginal supply which is virtually free.

Land has long been regarded as a peculiarly promising tax base because it cannot emigrate from a jurisdiction, nor be used up, nor otherwise flee from taxes. Marginal land is not sterilized by taxes on land rent or land value, because marginal land has neither (a point known to fame since Ricardo's *Principles*, Chap. X, "Taxes on Rents" [26]). So if an intertemporally neutral tax should fall on land rent the tax would not be shifted, but would remain neutral. It would never, like a tax on capital, lower the marginal efficiency of capital. To what extent does our present tax system take advantage of these opportunities?

Beginning with the excise tax, it favors land enormously because land never turns over. Only the net income of land could be subject to a retail sales tax. In practice, even that is often exempt. Whoever heard of an excise tax on ground rents from long term leases, for example, or on slum rentals, or on landlords' crop shares, or on implicit income from owner-occupied residences, or on parking fees? Excise taxes are a landowner's best friend. The doctrine that a general retail sales tax such as exists in many states is approximately neutral in its effects on sellers by virtue of its general application should be thoroughly discredited.

The income tax is quite another matter. Costs are deductible, so there is no tax on turnover, and no inherent bias in favor of land. On the contrary, the various devices for advancing write-off of depreciable or recoverable capital before capital recovery, although they do bias investors to longevity, should not bias them toward land, the most long-lived of assets, because land is not supposed to be written off at all. Rather, they tend

by partially exempting capital from taxes to throw more burden onto land.

A simple tax on the net income of land would, so long as the land is unappreciating, lower income by the full tax rate, just as with Bessie's milk; and that would seem to be the end of it.

But it is hardly the beginning. In fact, land escapes the full impact of the tax rate in several ways: by being written off in disregard of law; by appreciating; by yielding deferred periodic incomes; by capturing the value of land development investments; and by submitting to capture under the rule of prescription. We will treat these in order.

Taxpayers have not found it very difficult to write off land purchases. Would that the I.R.S. offered as little resistance to the efforts of professional men to write off training costs. It is only necessary that one buy land under an old building. Then he allocates most of the purchase price to the depreciable building, and writes it off as depreciation—never mind how many times it has been written off before.<sup>39</sup> Thus land which the law says is not depreciable at all, may be written off not just once, but several times!

Were it not for this device the income tax would serve as an effective stimulus to urban renewal. Once the cost of an old building was completely written off the current operating income would be fully taxable. The law would recognize it for what it is, pure ground rent, and recognize the building for what it is, an empty shell, a shade enduring a life-after-death. Thus in the year after the last write-off the slum owner would suddenly face a much higher tax bill, which he could then mitigate by giving consumers what they want, a new building, and writing off its cost.

But under present practice the surest way to lose the privilege of writing off the cost of land is to clear it and erect a new building. For then the I.R.S., seeing through a glass darkly, finally perceives that what you bought really was not the old building but the land beneath it—and denies write-off. (After all, *someone* has to pay taxes to finance those Urban Renewal subsidies!) The net effect is this: you can depreciate land so long as you do not improve it.

The fact that land can be written off, even if only once, casts an entirely different light on the question of tax bias. To write off something which lasts forever is to receive from the Treasury a large share of the cost of an asset which continues to yield its income to you in perpetuity. After the last write-off the Treasury gets only a return on its investment. The land-

<sup>39</sup> If challenged, he can refer to the local assessor's allocation, which almost always understates the land component, partly no doubt to accommodate local people in their dealings with I.R.S., which accepts the local assessor's breakdown as conclusive evidence.

owner's equity is reduced by the full amount of the rebate, and on that reduced investment he receives an income 100 per cent tax-free. From the moment of full write-off, the land purchase has been handled as if it were a current expense,<sup>40</sup> like a disposable paper towel.

It has been suggested in the past that the fiscal authority should buy from landowners the right to tax them, *i.e.* it should compensate landowners before raising their taxes. By letting them write off land, that is exactly what it has done. Only the operation has been quiet and unacknowledged, and has not been matched by equal generosity to salaried men, who pay taxes for the original sin of being born, the curse of Adam, the privilege of giving involuntary military service, and the folly of voting for men who show them their interest in their ruin and their ruin in their interest. How the ancient gods must be laughing!

Not all land is written off, to be sure. It has to be income property; it has to be bought for a good price and under an old building. Owner-occupied residential land and the houses on it are exempt, as everyone knows, because implicit income is tax-free. Fringe land, we will show, is largely exempt because of appreciation. But there is another large class of land that achieves its exemption by write-off: minerals. I have treated this case elsewhere [14; see Editorial Conclusions]. Suffice it here that the depletion allowance lets the investor recover, tax free, not only his discovery and development costs (which have already achieved tax exemption by being written off as expenses), but the value of the mineral rights before discovery, a pure rent, a value that grew up from nothing and on which no income tax was ever levied.

A second way that land receives a lower effective tax rate is through appreciation. If the land is held idle while appreciating, the case is like that of the tree. In an informed market the market value grows at compound interest, so that each year's gain is automatically plowed back into the base and earns interest in the following years. But this income is not taxed year by year as it is constructively received and goes to work earning more income. The tax is deferred until sale, at which time the rate is one-half or less than on ordinary income.

It is sometimes alleged that land and common stock price increments are not income because they are the price of future income; and that to tax them as well as the future ordinary income they yield is double taxation.

<sup>40</sup> If he sells, the landowner is taxed on the gain, seemingly limiting the time of the exemption. But he need never sell; and if he does the tax is deferred, and at capital-gains rates. Remember, too, that most of the write-off is taken well before the year of *full* write-off. Remember, finally, that the new owner may, and does, repeat the process, until the time of demolition and renewal.

Fortunately this is not a great issue—the law does recognize such gains as income. Anyone denying that the increment is truly income must be hard put to explain why the investor has kept his money tied up in idle land for 20 years. But the favored treatment capital gains receive may reflect some residual influence of the double taxation notion, so let us refute it.

Land prices rise because the passage of time brings higher future incomes closer to the present. This is a benefit above and beyond the incomes themselves. Value rises from the approach of higher future incomes, without any of them having necessarily been received. It is true that part of the future incomes will be taken by taxes; but land prices stem from the income after taxes, and price increments arise from the temporal approach of these higher after-tax incomes.

Putting it another way, suppose that after 20 years the original owner sold his appreciated land, and invested the gain in an earning asset. The land yields an income for the new owner; the new asset yields another income to the original owner. But now there are two incomes where there was one before. Or suppose the original owner spends the gain on consumption. He has consumed his entire income—yet the new owner continues to receive income, unabated, and the old owner has not drawn down his original capital but just consumed from income.

Appreciation is income for the same reason that depreciation is deductible from income. True depreciation is the present value of a loss or deferral of future income; appreciation is the present value of a gain or advance of future income. Indeed, referring back to Equation (12) it is evident that true depreciation is net of the unrealized appreciation of the unexhausted parts of an asset. So true depreciation already entails the concept of taxing unrealized appreciation. Annual taxation of unrealized appreciation is consistent with our definition of true depreciation, and *not* to tax the former would be inconsistent and unbalanced and would result in a distorted tax system.

So land appreciation is income, just like tree appreciation, and a neutral tax would take it as it accrues each year. The present system of deferred taxation grants it a lower effective rate, thus making purchase of land with appreciation potential relatively more attractive than it would be in the absence of taxes.

Another way of perceiving the point, one which would apply as well to the tree case, is to think of tax deferment on unrealized appreciation as tantamount to plowing back income into the land investment and *automatically allowing it to be written off as expenses*, deferring the tax until later. Thus the principle of taxing realized rather than accrued income is

the same as granting the expensing privilege to each year's added incremental investment in the land value.

The privileged nature of this treatment may be appreciated by comparing the tax treatment of an E bond held in one's safe-deposit box. The law is explicit: declare and pay tax on the yearly interest, even though you never touch it and indeed cannot do so without penalty. Or consider the treatment of contributions to some pension funds. These are involuntary; withheld from wages; non-transferable; forfeitable; non-bankable—but fully taxable in the year withheld.<sup>41</sup> Or compare the F.I.C.A. payroll tax. Employees pay income tax on gross salary before the F.I.C.A. deduction, even though benefits are deferred to age 65—for those who survive.

Appreciating land enjoys further advantages due to its permanence. Comparing land with trees, land gets the better tax break because trees have to be cut and sold when ripe. Not so with land: it need never be sold, and if the owner has bought it for "expansion" in the future, he will have achieved a tax-free income when his need arrives. (He gets free something he would have paid for.) If the owner can hold on until death do the land and him part, his heir begins again with the higher basis, the tax being forgiven forever [31]. If he sells his "residence"—or a large lot around his house which a complaisant I.R.S. accepts as such—he can defer the tax by reinvesting in another residence within one year of sale. If his land is condemned he can do the same. If he is 65 or over he may be able to avoid the tax under a new law. Or if the land is a "farm" he can barter it, tax-free, for a larger "like property" further out of town, letting the new owner with a higher basis subdivide the appreciated one.<sup>42</sup> Or he can donate appreciated land to charity or education, writing off the appraised value without ever having paid a tax on the appreciation, and enjoy use of the land until death. All the local taxes and interest that he may pay during his wait are expensable even though they are properly viewed as part of the long-term investment itself and should

<sup>41</sup> Later growth of the fund at interest is not usually taxable until later, softening the contrast in treatment. Some pension fund contributions are not taxable even initially. There is great individual variation, much of it capricious. Contributions to the Wisconsin State Employees Retirement Fund, for one example, are taxable although not received.

<sup>42</sup> Section 1031 of the Internal Revenue Code provides: "No gain or loss shall be recognized if property held for productive use in trade or business or for investment (not including stock, etc.) is exchanged solely for property of a like kind to be held either for productive use in trade or business or for investment."

There is a good deal of "tailoring" of transactions to fit the letter. A prospective buyer of a suburban farm for cash may instead buy a rural farm (satisfactory to the prospective seller) and then swap farms with him. The rural land of "like kind" might also be a golf course, airport, cemetery, quarry, dump, etc. A network of brokers' clubs has developed to arrange such bartering.

be capitalized [8]. If he loses on a sale he can deduct the loss from ordinary income, often selecting the year of loss realization for his greatest convenience. He can sell on the installment plan and pay taxes only as the installments come in. He can sell on a contingent price basis and count all payments as non-taxable capital recovery until he has recovered his full basis, and only then start paying taxes—another long deferral of liability. If overall losses pile up, he can delay realization until after merger with a profit-making business. If the landowner is a church, school, charitable or fraternal or cemetery organization, its gains may be exempt, even though the same organizations would be taxed if they made money by rendering services. It is no straight narrow path that leads down to exemption, but a royal road, toll-free, posted and blazed all the way, with clergymen and educators for respectable companionship.<sup>43</sup>

A neutral income tax on increments to land value would take as its base the annual appreciation. In equilibrium the appreciation will just cover interest on the value at the beginning of the year (assuming, for simplicity, no other taxes or other carrying costs). Here, just as in the tree case, the neutral income tax base transforms the income tax into the property tax. If  $S_n \equiv$  site value in any year, the neutral income tax base is  $S_{n.i}$ . The property tax base is  $S_n$ . In this case  $i$  is not lowered by the tax—land supply being fixed, the tax is entirely absorbed by land in lower values of  $S_0$ , following the traditional theory of land tax capitalization worked out by Jensen [19]. Tax anticipation lowers  $S_0$ —the early value base from which appreciation begins—by whatever amount may be necessary to let the holder earn  $i$  per cent while he holds it idle for appreciation.

A long-standing criticism of the property tax applied to suburban land that is rising in value is that use of capital value rather than current annual value as the base results in overtaxation of the land. The implicit assumption is that appreciation is not income and should be tax-free. The reason land sells for more than capitalized current income is the expectation of higher future income. This is not a static condition, but a journey between equilibria.<sup>44</sup> Each year the higher future moves closer to the present, a blessing signaled by the value's rising at  $i$  per cent. That is an income. Once that be accepted, and the bias of deferred taxation be accepted, then it follows that the capital value base is a way to tax this income, and more-

<sup>43</sup> On these matters the writer has received valuable insights from John Denton, Douglas Kilbourn, Daniel R. Dixon, and Ben Musa, to all of whom he offers sincere thanks. An excellent treatment is found in William Scofield's "Value and Competition for Land" [27].

<sup>44</sup> This helps explain the profession's difficulty in coming to grips with the question. We have all been nursed on statics.

over the best way, a neutral way. It may be done by use of either the property tax or the income tax.

In the analogous tree case we had to qualify our conclusions drastically on considering shifting. Here the analogy ceases, for there is no shifting of the land tax. It does not lower the rate of return in the first place, but rather the cost of buying the asset on which the return is reckoned. The asset being fixed in supply, that ends the chain of reaction.<sup>45</sup> There is no destruction of marginal supply, because the tax on marginal land is zero. There is no flight of tax base by emigration, by retarded turnover, or dis-saving.

These matters may be clarified by constructing a model of land which appreciates and at the same time yields ordinary income. We call it the "Perpetual Appreciation" or PA model.

Suppose a (piece of) land yields a yearly income above current costs that grows by  $g$  per cent each year.<sup>46</sup> Let the income at the end of the initial year be  $1$ . The site value,  $S_0$ , is the sum of the progression:

$$(15) \quad S_0 = \frac{1}{1+i} + \frac{1+g}{(1+i)^2} + \dots + \frac{(1+g)^\infty}{(1+i)^\infty} \quad (g < i)$$

$$S_0 = \frac{1}{1+i} \cdot \frac{1}{1 - \frac{1+g}{1+i}} = \frac{1}{1+i-1-g} = \frac{1}{i-g}$$

From (15) it follows that

$$(15a) \quad S_0 i = 1 + S_0 g$$

That means that  $S_0 i > 1$ .  $1$  is the yearly cash income. Therefore the income is too little to cover carrying costs and to warrant anyone's holding the land, with or without taxes. Shall we then conclude that no one can afford to own this land at the alleged price  $S_0$ ?

How can anyone behave economically in this rising land market and add enough land to his holdings to equate marginal net yields with marginal carrying costs? Very simple: he counts the yearly increment as income *in the year it accrues* in the form of higher land price.<sup>47</sup> Anyone denying this must also deny that the land market works economically. The yearly deficit he must cover is  $S_0 i - 1$ , which from (15a) equals  $S_0 g$ . But  $S_0 g$  is

<sup>45</sup> Or it would, if truth were altogether that simple. We still must consider the practical effect of lower land prices on the production of Wicksell's "rent-goods," or land development investments. We table that question for a few paragraphs. For the present, consider these investments to be skillfully deducted by the assessor in measuring the land value tax base, which rises because of the approach of the city and publicly financed works exogenous to the owner.

<sup>46</sup> For a thorough discussion of this case see Leon Walras [40].

<sup>47</sup> The writer is indebted to Mr. Nicolaus Tideman for introducing this concept.

exactly the yearly appreciation of  $S_0$ :

$$(16) \quad S_1 - S_0 = \frac{1+g}{i-g} - \frac{1}{i-g} = \frac{g}{i-g} = S_0 g$$

Therefore the cost of carrying land each year at the price- $S$  is just covered by the sum of net cash income plus current appreciation. Thus, if traditional valuation theory is correct, investors put a value on appreciating land which treats current appreciation as current income. Why, then, should an income tax on it be deferred? No reason in the world unless we intend, as a matter of deliberate public policy, to give partial tax exemption to landowners. For that is just what the present policy does when it defers taxation of capital gains until time of cash sale.

In this case, as in all previous cases analyzed, an intertemporally neutral tax is one that taxes a constant percentage of current income, and current income is a constant percentage of capital value.

We emphasize that the PA model clears away an alleged practical difficulty of including asset accretion in current income. Henry Simons, William Vickrey, and Irving Fisher all saw the intertemporal neutrality of the accrued basis. They hesitated before the practical problem of appraising property each year to tax the increment. The 1961 Joint Economic Committee added a jaundiced caveat [43, 69], as did Lawrence Seltzer [28, 40].

What we have just shown, however, is that the property tax that takes a percentage of capital value *automatically taxes increments*. No further increment tax is needed. So what we propose is not an innovation with no practical possibilities, but a strengthening and extension of the property tax on capital value, which we have always had. Be it further noted that it is quite inconsistent to claim that alleged practical difficulties prevent annual tax recognition of positive appreciation in a system that has devised several ways to allow negative appreciation annually.

A third general way for landowners to receive a lower tax rate is to select time patterns of land use that sacrifice smaller early rents for larger late rents. This is a form of investment, on the whole a legitimate one. Like all investments, these may enjoy some tax abatement by deferral of realization. The cost is the early foregone rent, the payout is the later premium rent. Not all land offers opportunity for this maneuver. There must be some intertemporal interdependence of rents. Examples are: starting new orchards (which require 5–10 barren early land-years as an input); forestry, deferral of mineral extraction (the L. C. Gray example with which we opened our Introduction); deferring site renewal in transitional land-use areas awaiting greater "ripeness" or certainty.<sup>48</sup>

<sup>48</sup> Another example is writing long term ground leases wherein early rents are low

The cost is not explicit, but is still as good as expensable since no tax is due on the foregone rent that would otherwise have been taxable cash income. That is, the effect is the same as though the early rent were received in cash and then reinvested and expensed. A good term for this is "implicit expensing." It is not reserved to landowners. The student who foregoes present income to devote his time to an education for enhanced future income is implicitly expensing the investment of his time as well. But land is a convenient vehicle for a great deal of this kind of thing, more so than other assets, because of its infinite life. Expensing, as we have seen, is tantamount to complete tax exemption. That is not to say that the entire land rent achieves exemption, but the gain from deferral does.

In this case that is not necessarily a bad thing. It means that a tax on land income, taken by itself, is intertemporally neutral.

Let us take a point-input point-output case on good land, where the investment has to grow fast enough to yield a rent (or a market return on the site value) as well as interest on the initial non-land costs,  $C_0$ . There is a periodic surplus of gross income over compounded  $C_0$ , which surplus we call the periodic rent,  $A_m$ .  $m$  is the year of maturity, and  $A$  is the periodic equivalent of  $a$ , the annuity rent.  $A_m$  and  $a$  are related by a standard tabulated financial formula:

$$(17) \quad a = A_m \frac{i}{(1+i)^m - 1}$$

At the interest rate  $i$  the investor is indifferent between the yearly rent and a periodic rent,  $A_m$ .

In the absence of any disturbance to  $i$ , a tax on  $A_m$  is equivalent to a tax on  $a$ , and leaves the indifference unchanged. That is:

$$(17a) \quad a(1-t) = A_m(1-t) \frac{i}{(1+i)^m - 1}$$

reduces to (17) because the factor  $(1-t)$  cancels. The tax on rent does not itself disturb  $i$ , and so long as nothing else does either, the tax is neutral. The reason the tax does not change  $i$  is that it is fully absorbed into

and later ones high. This might seem to be offset by an equal and opposite tax disadvantage to the lessee, but on the other hand it is a means of extending him credit at a time when he needs a lot, and it reduces his cost deduction during early years of high write-off, so it often suits nicely to maximize joint (after-tax) benefits of lessor and lessee. One also has the option of selling for capital gains just before the higher rent years.

Another device is to allow lower rent in consideration for the lessee's leaving a good building at lease-end, which the fee-holder acquires tax free (taxable as a capital gain if he should ever sell) [33, 156-58].

lower site values,  $S$ . One continues to earn a market return on the reduced base. There is no loss of marginal production, and hence no shifting, because on marginal land the tax base is zero.

Why is the taxpayer indifferent between an earlier and a later tax in this case? Because the later tax is higher.  $A_m$ , the later tax base, is greater than  $\sum_{n=1}^m a_n$ , the earlier tax base. (17) is derived by compounding

each  $a_n$  forward to year  $m$ , so  $A_m = \sum_{n=1}^m a_n (1+i)^{m-n}$ . The excess of  $A_m$

over  $\sum_{n=1}^m a_n$  is compound interest on the earlier payments foregone.  $A_m$  is a sinking fund which grows each year by the current payment plus interest on accrued payments. So the tax liability deferred each year grows at compound interest, and the taxpayer does not abate the tax by deferring realization.

It might seem now that the tax on deferred land income is also a tax on the interest earned by deferral of use. But it definitely is not so, and it is important to understand why not, both to clarify the present point and for all analysis of the fascinating relationships of rent and interest. So far in this paper we have skirted the second matter, which is, however, central to any analysis of tax shifting.

Consider one year's rent,  $a_1$ , due at the end of year zero. Suppose the landowner defers it. He is plowing it back into his land-use plan. At the end of year  $m$  he realizes it at compound interest, and it is worth  $a_1 (1+i)^m$ .

The tax on it,  $T$ , also grows at compound interest. Had it been taxed at the end of year zero,  $T_1 = t \cdot a_1$ ; being taxed at the end of year  $m$ ,  $T_m = t \cdot a_1 (1+i)^m$ , so  $T_m = T_1 (1+i)^m$ .

But if we were taxing interest,  $T_m$  would have to be greater than  $T_1 (1+i)^m$ , to cut into  $i$ . When  $T_m = T_1 (1+i)^m$  we are letting the landowner earn the gross-of-tax rate return on his investment in deferral of land rent. We just aren't letting him earn any more than that. But we are not taxing interest.

This explains the L. C. Gray example of minerals conservation with which we opened our Introduction. The miner who defers extraction is foregoing, and thereby investing, current rent to gain enhanced future rent. A tax on the pure rent income is intertemporally neutral because the after-tax rent grows over time at the same percentage as the full rent.<sup>49</sup>

<sup>49</sup> For modern treatments of Gray's principle see Orris Herfindahl, "Depletion and Economic Theory" [17]; and William Vickrey, "Economic Criteria for Optimum Rates

So the part of the income tax that falls on land rent is intertemporally neutral. But let there be a tax on interest, so  $r < i$ , and there is a premium on deferring realization of land rents, just as there is on other deferrals of tax liability. Any deferral that yields at the rate  $i$  now yields the investor more than  $r$ , the after-tax yield on alternative investments. So landowners alter their use plans toward the future until they reach a new equilibrium.

Referring back to equation (17) since  $a = A_m \frac{i}{(1+i)^m - 1}$  then

$a < A_m \frac{r}{(1+r)^m - 1}$ . It now requires a higher annuity,  $a'$ , to be as attractive to taxpayers as  $A_m$ , and lower and later deferred rents that were submarginal now become interesting for landowners.

A good way to perceive this, a way that is equivalent to the use of calculus, is to think of how to maximize  $a$  when  $A_m$  is a positive function of  $m$ .  $a$  reaches its maximum in the year when the percentage increase of numerator and denominator in (17) are equal, which could be phrased "when the elasticity of the ratio equals one." The percentage increase of the denominator is positively related to  $i$  or  $r$ , whichever is used; and for large values of  $m$  becomes virtually equal to  $i$  or  $r$ . The year when unit elasticity is reached using  $i$ , the elasticity using  $r$  is still greater than one, because  $r < i$ . So at the after-tax rate,  $r$ , the taxpayer maximizes  $a$  by choosing longer cycles. In general, all later rents gain lustre relative to earlier ones, so all land-use plans are re-timed towards the future.

The lowering of  $r$  below  $i$  lightens the tax burden on the landowner who defers rent in three ways:

—  $A_m$  converts to a higher annuity at  $r$  than at  $i$ . ( $A_m$  remains the same by the assumption of no tax shifting.)

— the annuity value rises as  $A_m$  is deferred to  $(m+x)$  in response to the lower rate of return.

— the annuity is capitalized into land value at  $r$  instead of  $i$ . Since  $r = i(1-t)$ , and the annuity falls by less than the factor  $(1-t)$  due to deferral of  $A_m$  to  $(m+x)$ , the capital value of land will actually rise—a little capital gain on top of everything else!

But what if the tax on capital is shifted, so that  $r = i_b$  (recall that  $i_b$  is the base rate of return in the absence of taxes)? In general the shifting will be to land, if the tax jurisdiction is small, because then wage rates,

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of Depletion" [39]. Both appear in Mason Gaffney (editor) *Extractive Resources and Taxation* [14]. The editor in his Conclusion then seeks to expand the principle to account for durable investments in mining improvements.

interest rates, material costs, and product prices are parameters exogenously set, and land may be treated as the residual claimant in the simple old manner of classical theory. Then the value  $A_m$ , the periodic land rent, becomes smaller by the amount necessary to absorb the tax; and site value,  $S$ , drops in the same proportion.

But this drop in land rent tends to retard the maturity of investments on the land. Timber, for example, is financially mature when its yearly growth increment,  $g'$ , is no longer enough to cover interest on the sum of its salvage or stumpage value,  $g$ , plus the site value,  $S$ . If site value is lower, and all other parameters remain the same, harvest comes later.<sup>50</sup> As a secondary effect, this will somewhat abate the drop of site value, reflecting the value of tax avoidance.

The essence of the matter may be grasped from the equation relating rate of return to site value. If we require a tree to yield a return on the land it uses, as well as the depreciable costs, the return is defined by equation (18).

$$(18) \quad (1+i)^m = \frac{R_m + S}{C_0 + S}$$

After a tax, fully shifted to  $S$ :

$$(19) \quad (1+i)^m = \frac{R_m + S - t(R_m - C_0)}{C + S}$$

It requires a lower value of  $S$  to satisfy (19) than (18), so the marginal growth of  $R_m$  that was just enough to pay the carrying costs on  $R_m$  and  $S$  is now superabundant, and enough to carry the tree a few years longer.

Another, but equivalent, approach is to solve for  $S$  and maximize it:

$$(19a) \quad S = \frac{R_m - t(R_m - C_0) - C_0(1+i)^m}{(1+i)^m - 1}$$

Deducting taxes from the numerator increases its percentage growth rate and defers the date of  $m$  at which  $S$  is maximized.

So a tax on interest income, whether or not shifted, tends to favor time-patterns of land use that emphasize future over present realization of taxable rent income. The present paper only scratches the surface of the relationships between interest income and rent. We regard this as of first priority for extended treatment in a sequel. But to hold the present paper within bounds, we close the matter here.

A fourth way that land achieves tax exemption is by its close association with the production of Wicksell's "rent-goods," perdurable invest-

<sup>50</sup> This is based on the Faustmann formula of classical forestry economics. For an extended treatment of this point see M. Gaffney, *Concepts of Financial Maturity of Timber* [13].

ments in land development which take on some of the character of land itself, and whose life span is so long that for most practical purposes they may be treated as permanent. These include cuts and fills, some kinds of grading, draining, damming, etc. Professor Martin Bailey has taken fills in shallow water to represent the genus, and we borrow his example [2].

To begin, these investments produce land substitutes. Anything that raises the price of land tends to divert investment into land substitutes. The first three biases above tend to raise land prices and thus to stimulate the production of these land substitutes.

Any permanent fill whose cost may be written off, however slowly, finally achieves complete exemption from income tax, following the reasoning already expounded. Thus the after-tax yearly rate of return,  $r$ , for fill-type investments is made higher than for shorter ones yielding the same pretax rate of return,  $i$ . "Grading" is part of the land investment and non-depreciable, but many other investments of this type may be written off quite legally. Those that are not depreciated are prorated among the lots and written off as lots are sold—a sort of depletion allowance for land developers—so that land development firms often make their taxable profit entirely on the last few lots sold, deferring taxes to the very end of the sales operation. This kind of tax advantage is hard to come by in enterprises that produce in an endless stream.

But all that is disequilibrating and leads to shifting. The premium on fill returns draws investors into fills until the  $r$ 's are equalized on all investments. The beneficiary of shifting is then the owner of land under shallow water. The price of such land, whose supply is limited and inelastic, rises to absorb the premium on fill returns.

Some of the premium might conceivably be shifted forward to land users in lower rents and sale prices. However, filled land is not a differentiated commodity but a perfect substitute for naturally dry land, so the shifting forward, if any, is trifling compared to the shifting backward (in this case "downward!") to the owners of sites under shallow water, which are scarce and differentiated. The capital frozen in fill-type investments is permanently preempted from alternative uses on superior land, some of which land is thus withdrawn from use. The net result probably is to reduce the effective land supply.

Sometimes the "fill" is financed not by landowners as individuals but by landowners collectively, organized in that syndicate of landowners known as municipal government. Now we are speaking of "public" works. This subsidy takes the form of the exemption of municipal bonds from federal income tax, so landowners can sell them for a better price and

plan more long-lived investments, coupled with the deductibility of local taxes by which landowners pay off these bonds—a double subsidy when one considers that bond service includes repayment of principal faster than the works depreciate.<sup>51</sup> If the works are federal, there are no increased local taxes at all, and the longevity of investments is calculated at interest rates far below the market, sometimes zero. This advantage goes into enhancing land values.

This gives us an insight into shifting that applies over the whole range of topics we have covered. The specific beneficiary of the premium on longevity is the owner of those lands which are better suited to long investments. The specific sufferer is the owner of land on which short investments are better. That is as far as partial analysis can take us. The wider effects are those of retarding the turnover and replacement of a nation's capital, which shifts the whole burden from property to labor, following Wicksell's analysis. To Wicksell we add that slowing replacement also means piling up limited capital on fewer sites which are cleared and renewed less often, enhancing the bargaining position of land relative to labor.<sup>52</sup> The ultimate victim is in general labor.

A fifth means by which land benefits from tax bias is through that pervading institution, the rule of prescription. Submarginal land, whose tenure is often uncertain, is subject to capture by virtue of occupancy and use. No one would use submarginal land, ideally. But people will use it if both (a) they expect it to become rentable in the future, and (b) present use establishes future ownership. The appropriative doctrine of water law in the 17 Western states is a splendid example of the rule of prescription.

The result is to cause investors to develop and use resources while they are still submarginal. They suffer early losses, many of them in the guise of expensable current costs, in order to establish their history of use. The payoff on this investment is the effective ownership of the resource in the future, when it will bear rent.

Our income tax system, with its bias to longevity, puts a special premium on this kind of land acquisition. The "purchase price" of land—the early

<sup>51</sup> Who else gets to deduct repayment of principal at all?

<sup>52</sup> One might think that these subsidies to land development would in the aggregate result in more land development, eventuating in an artificial abundance of land, shifting the tax burden to landowners in lower rents. But that would be to assume a limitless supply of capital. In fact, the more capital we sink into developing submarginal land, the less remains to improve and fructify naturally superior land, and to complement labor in enterprises where capital cycles faster. In a nutshell, capital complements labor by turning over, which requires labor, and complements land by standing still, which requires land, so slow turnover favors land over labor. Cf. footnotes 3, 20.

losses is fully deductible, much of it immediately as current expense. The payoff—the ownership of title to the appreciated resource—is not taxable at all unless or until sold. Thus the premature use of submarginal resources, which would be uneconomical enough in the absence of any taxes, receives an added stimulus from the income tax.

This kind of investment motivation, even in its pure form, is much more widespread than one would guess from the silence it has evoked. Minerals exploration, acquisition of television frequencies (often with preclusive or preemptive overtones), and premature extension of utility lines to capture developing territory are obvious examples.

But when we extend the concept a bit, the generality of it becomes remarkable. Wicksell once noted that: "because of the local character of the firm and its market," . . . "the large enterprise has an actual monopoly simply because it comes first on the scene, and this monopoly may be as good as a monopoly which is legally established." Competition by a second firm "would only lead to the ruin of both." [41, 131].

Now look at retailers jockeying for position around every growing city, to appreciate the man's prescience. Where there is only room for one store of a kind in an area, to be there first is to win a sort of franchise or prescriptive right to the territory.

There is also the zoning matter. The more offensive a land use is to its neighbors, the more important for the firm to establish the use early and establish a history of noise, air pollution, heavy traffic, garish signs, apartments, or whatever, long before a municipality begins zoning. Thus submarginal gasoline stations, for example, sprout up at every crossroads in suburbia and exurbia in one of the greatest urban land speculations in history by the largest corporations in the world, the international major oil companies. The early losses are expensable, the future preferential zoning is tax-free. Land is the vehicle by which the gains are secured, and the income tax is the supercharger on the motor.

Once one sees the pattern, the examples are legion, and every reader can supply his own. "Possession is nine points of the law," "grandfather clause," "vested interest," "sooner," "racing for position," "right of customary usage," "rule of capture," "seniority," "adverse possession," "squatter's rights," "historical base period," "residence requirement," "proving a claim," "finders keepers," "old-law tenements," "prior appropriation," "first in time is first in right," "earliest market," "first in time is first in right," "goodwill,"

before the taxonomic favor that society has always granted to prior possession. If the income tax did not have been granted in relative abundance

Summarizing, we find a market bias in favor of land, because of its longevity; because it does not turn over; because it may in fact be written off; because it appreciates; because its rent may be deferred; because it may be enhanced by investment of the most durable kinds; and because it may be captured, and/or its value to the individual owner enhanced, by absorbing early losses.

This bias has implications for distribution, allocation, and macroeconomics. Distributionally, the lower effective rate on land means higher rates are imposed on labor and capital. Allocationally, the high price of land motivates diversion of capital to land substitutes, both private and public, whose longevity is extreme; and the favor given these investments adds to the motivation. Macroeconomically, much capital is destroyed by the losses taken to secure prescriptive rights to land, and that which remains has a replacement rate far slower than would be optimal.

(Continued)

*Resources for the Future, Inc.*  
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### *Children's Plight in Developing Countries*

"EVERY HALF MINUTE, 100 children are born in developing countries. Twenty of them will die within the year. Of the 80 who survive, 60 will have no access to modern medical care during their childhood. An equal number will suffer from malnutrition during their crucial early years, with the possibility of irreversible physical and mental damage. Their chances of dying early will be 20 to 40 times higher than if they lived in Europe or North America.

"Of those who live to school age, only a little more than half will ever set foot in a classroom, and less than 4 out of 10 of those who do will complete the elementary grades."

These few blunt facts might be called portents of the "State of the World for the Year 2000," for they are from a recent report of the UN Secretary-General, U Thant. He didn't have to add that today's children are tomorrow's adults.

The United Nations Children's Fund is the agency of the UN family charged with special concern for the children of the world. UNICEF has just decided to try to double—within the next five years—the assistance it is now providing 112 developing countries to help their children. It has taken the Children's Fund 24 years to reach its present income level, yet its sense of urgency is so great that UNICEF hopes to do twice as much by 1975. [From the U.S. Committee for UNICEF.]

## Factors Influencing Member Participation in Trade Union Activities

By MARTIN M. PERLINE AND V. R. LORENZ

Are you an active member, the kind that would be missed?  
Or are you just contented, that your name is on the list?  
Do you attend the meetings, and mingle with the flock?  
Or do you stay at home to criticize and knock?  
Do you ever go to visit a member who is sick?  
Or leave the work to just a few and talk about the clique?  
Think this over, member—you know right from wrong.  
Are you an active member, or do you just belong?<sup>1</sup>

A LOCAL UNION PRESIDENT presented to an international union conference this effort to illustrate in verse the member participation problem confronting the contemporary union movement. While a considerable amount of creative thought has been devoted to this problem by union leaders, their attempts to find answers to the reasons for the lack of member participation have not always been successful.

The union leaders have, therefore, sought the advice and counsel of sociologists, economists, and statisticians; and their tools of inquiry have ranged from simple direct response observation to exacting empirical investigations statistically designed and analyzed. No one school of thought, however, can claim a complete monopoly of insight into this area since the factors influencing participation are numerous. The following review of the literature seeks to investigate the extensive findings which have been published and attempts to present a sociological generalization of union members' habits with reference to their participation as individual members, as well as to their participation as a group.

### Individual Participation Variables

THE FIRST GENERAL AREA to be discussed, individual characteristics, can be approached several ways. One approach classifies individual participation variables in the usual demographic manner; others describe the individual by his psychological attitudes and the manner in which he perceives his particular job environment.

By far, the most common type of inquiry rates the first area, demographic individual characteristics, high on the list of directly observable traits of member activity. This kind of study describes active members as having better skills and better jobs, being older in age and higher in seniority, as

<sup>1</sup> Author unknown, quoted by Arnold S. Tannenbaum and Robert L. Kahn, *Participation in Union Locals* (Evanston, Ill.: Roy, Peterson and Co., 1956), p. 42.

well as being more likely to be married.<sup>2</sup> At this point, similarity ends due to the search for additional variables.

According to one school of thought, the individual member possesses various mental attitudes that explain his activity within a group.<sup>3</sup> The member, therefore, enters membership seeking to find an atmosphere compatible with his psychological needs. In many cases, the active individual identifies with the idealistic union norms and attitudes since his own attitude is a part of his family background.<sup>4</sup> Consciously or subconsciously, the attraction to union causes is a part of union sympathy developed early in life.<sup>5</sup>

As a part of the psychological composition of the union member, class consciousness is related to the norms with which he identifies. One probe of individual activity suggested:

[an active member seems] . . . to be especially interested in helping the "working man" as an ethical or religious imperative. Whether he does or does not have a combative attitude towards management, the activist is "class conscious," that is, he sees himself as a worker, and tends to perceive industrial disputes from the vantage point of the "workers" rather than from the side of management.<sup>6</sup>

On the other hand, another study found:

[there is] . . . little if any consistent indication of "class consciousness" in [the active member's] . . . behavior. We find no evidence that he is more likely to choose friends from the working class, or to tend more to join "working class" organizations. He does appear to join more organizations and to be somewhat less provincial in his friendship choices. This may result simply from his greater enjoyment and appetite for [the] social process.<sup>7</sup>

Thus, there seems to be no agreement as to the class conscious perceptions of the active union member. It is believed, however, that in order to join the union, the active member must identify, to some extent, with the attitudes of the union, and by doing so, he accepts the "worker" and

<sup>2</sup> *Ibid.*, p. 229, and Lois R. Dean, "Social Integration, Attitudes, and Union Activity," *Industrial and Labor Relations Review*, Vol. 8, No. 1 (October 1954), p. 51-52.

<sup>3</sup> S. M. Lipset, M. A. Trow, and J. S. Coleman, *Union Democracy: The Internal Politics of the International Typographical Union* (Glencoe, Ill.: The Free Press, 1956), p. 99.

<sup>4</sup> Tannenbaum, *op. cit.*, p. 231, and William Spinrad, "Correlates of Trade Union Participation: A Summary of the Literature," *American Sociological Review*, Vol. 25, No. 2 (April 1960), pp. 240-41, citing Theodore Purcell, *The Worker Speaks His Mind on Company and Union* (Cambridge, Mass.: Harvard University Press, 1953), p. 205.

<sup>5</sup> J. Seidman, J. London, and B. Karsh, "Leadership in a Local Union," *American Journal of Sociology*, Vol. 56, No. 3 (November 1950), pp. 229-37.

<sup>6</sup> Spinrad, *op. cit.*, p. 243, citing Purcell, *op. cit.*, pp. 211-12, and L. R. Sayles and G. Strauss, *The Local Union: Its Place in the Industrial Plant* (New York: Harper and Brothers, 1953), pp. 103-5.

<sup>7</sup> Tannenbaum and Kahn, *op. cit.*, p. 230.

management division of the industrial class. In this sense, he is class conscious. If he continues to participate, his activity depends upon many factors other than "class consciousness."

Other such variables influencing activity include certain basic psychological needs that the active member fulfills by participation. The active union member who is a leader may have a conscious "desire to obtain personal power, recognition, or financial gain."<sup>8</sup> In addition, one study found that the active member may seek a means for expression of his "gregarious" nature and, therefore, find the union environment conducive for his doing so. Several studies analyzed this trait by describing the activists as "outgoing, liking to deal with people, possessing high activity levels and nervous tension."<sup>9</sup> This social nature is transmitted to the union in the form of formal activities such as "meeting attendance, . . . voting behavior," and informal functions such as "the grievance process, [and] . . . campaigning for officers."<sup>10</sup>

One illustration of this social characteristic finds that the active member: . . . appears to be a different kind of person, perhaps a different personality type, from the inactive-more ascendant, outgoing, and social. He seems to derive satisfaction from social interaction, from doing things with people. His world, both inside the union, and out, is one in which he and his associates are doing, affecting, moving and to some extent controlling things.<sup>11</sup>

Similarly, one investigation found that the active union member, away from the work area, is more prone to associate with his fellow workers than a member who does not attend regular union meetings.<sup>12</sup> The study suggests that at least two-thirds of the active members observed do have many fellow worker friendships.<sup>13</sup> Union members also are more likely to be interested in their union if they associate with fellow union members away from the job in recreational activities.<sup>14</sup> The "gregarious" or social behavior of active individuals is thought to be, as mentioned before, the contributing factor in this instance. Thus, on and off-the-job contacts for fellow workers and fellow union members are important in that the social nature of the group is reinforced through continued involvement in the social life of fellow participants.

<sup>8</sup> Seidman, London, Karsh, *op. cit.*, p. 232.

<sup>9</sup> Spinrad, *op. cit.*, p. 242, citing J. Seidman, J. London, B. Karsh, and Daisy L. Tagliacozzo, *The Worker Views His Union* (Chicago: 1958), p. 191, citing Purcell, *op. cit.*, p. 210, citing Eli Ginzberg, *The Labor Leader: An Exploratory Study* (New York: 1948), pp. 92-93, and citing Sayles and Strauss, *op. cit.*, pp. 100-103.

<sup>10</sup> Tannenbaum and Kahn, *op. cit.*, p. 229.

<sup>11</sup> *Ibid.*

<sup>12</sup> Dean, *op. cit.*, p. 51.

<sup>13</sup> *Ibid.*

<sup>14</sup> Lipetz, Trow, and Coleman, *op. cit.*, p. 416.

Before we complete the discussion of individual participation factors, we must introduce the influence of the individual's perceptions of his job environment and the manner in which it influences participation. In the job environment the active member has a tendency to become identified with his particular occupation.<sup>15</sup> In a study by Sayles and Strauss, it was found that workers in similar occupations rallied to unions in protection and advancement of their interests, more often than did workers in unions which contained members whose occupations were more divergent.<sup>16</sup>

In addition to the job variable, occupational identification, the extent of work interest influences activity within a union. A study of the International Typographical Union found that member participation in union affairs is directly correlated with the extent of work interest and that active members are more likely to be interested in their work than inactive members.<sup>17</sup> Tannenbaum and Kahn's study, as well as a study conducted by Dean, agreed that actives were satisfied with their jobs more often than were the inactives.<sup>18</sup>

In regard to another job environment variable, Tannenbaum and Kahn have found little difference between actives and inactives as to hostility that might exist toward management. In some particular instances, however, hostility toward management does exist. When it is present, there is some conflict with the attitudes developed by the active member. Since the active member has a sustained interest in his job, in an instance of management hostility, the active may be motivated to bring about modification of the management-employee relationships, but, perhaps his ability to accept alteration is hampered by the tendency for preservation of his job and continued employment. Clearly, the active individual may be willing to change but may also want to conserve.<sup>19</sup>

We have separated the background and psychological attitudes of the active member, and, in so doing, we have described, to some extent, variables which influence participation. However, there are several factors that do not fit this neat descriptive scheme. First, there is a member who participates for a limited purpose and for a limited time. For instance, if he is faced with technological change that threatens future job opportunities, he may actively seek job protection from the union. If the objectives are limited and they are accomplished, then activity in such a situation may decline. In some cases, activity may cease because of limited

<sup>15</sup> *Ibid.*

<sup>16</sup> Sayles and Strauss, *op. cit.*, pp. 192-95.

<sup>17</sup> Lipset, Trow, and Coleman, *op. cit.*, p. 416.

<sup>18</sup> Tannenbaum and Kahn, *op. cit.*, p. 229, and Dean, *op. cit.*, p. 51.

<sup>19</sup> Tannenbaum and Kahn, *op. cit.*, pp. 229-31.

union success to achieve the member's objectives.<sup>20</sup> Therefore, if the member does participate, his continued participation, in both cases, depends upon the "economic, political and social rewards obtained."<sup>21</sup>

Another factor escaping labels is the member who becomes a leader only because of the inadequate supply of leaders necessary to achieve his personal objectives.<sup>22</sup>

In summary, the profiled active member, as an individual, has certain characteristics that set him apart from the inactive individual. He has higher skills, a better job, longer seniority, is older, and more likely to be married. He tends to approach issues with idealistic motivation; to some extent, class consciousness is prevalent; and he has a gregarious nature which is transmitted to the union and other social groups. Moreover, occupational similarity with fellow union members and job satisfaction are directly tied to union participation. Finally, if the individual has active characteristics, his continued participation, in most cases, depends upon the magnitude of union success in achieving economic and other union objectives.

#### Group Participation Variables

THIS SECTION INVESTIGATES various inquiries into the collective groupings of individuals. In order to understand the extent of group influence upon participation, we shall discuss first, group variables, and second, the primary characteristics of the groups.

Since World War II, a new kind of sociology has emerged which deals with the manner in which people interact within groups.<sup>23</sup> Consequently, patterns of behavior for group members have been clarified so that we may better understand the participation problem so prevalent in unions. Many examples of group behavior have been formulated, but perhaps the following passage illustrates them most adequately:

. . . an individual's initial assignment to a family and a neighborhood is ascribed—that is, determined by birth—but as he matures and develops interests, his memberships are less determined by ascriptive factors; he can decide which groups are most congenial to him and can join them. . . . Whether he aspires to membership or simply identifies with an ideal group, he will insofar as his position allows, assume the attitudes and behavior patterns he believes to be characteristic of that group. If the individual aspires to membership in a real group, such "anticipatory socialization"

<sup>20</sup> Sayles and Strauss, *op. cit.*, pp. 192-95.

<sup>21</sup> *Ibid.*, p. 195.

<sup>22</sup> Seidman, London, and Karsh, *op. cit.*, p. 232.

<sup>23</sup> Harold Guetzkow, "Group Processes," *Psychology and Life* (Chicago: Scott, Foresman and Co., 1942), p. 347.

makes it easier to be subsequently accepted only insofar as his attitudes and behavior correspond to the actual norms and values of the group.<sup>24</sup>

Regarding continuous membership in the group, the member is more likely to stay if he likes the members and identifies with the group objectives, than if he does not.<sup>25</sup> However, there are some groups that have qualities within their structures that foster participation for its members, while other groups are not conducive to member activity.

One investigation reasons that there are four factors which influence trade union participation. First, participation depends upon the "homogeneity" characteristics of the group that enable members to unite to achieve their objectives. Second, the member of a group is more likely to participate in a union group if his job gives him status or prestige in the plant. Third, the technological importance to the company of a group member's job influences his activity within a union group. Lastly, the particular nature of the member's job might affect his participation.<sup>26</sup>

The first, homogeneity, is of major importance in welding the group into active conditioning. While individuals may have the motivation to be active, they need the support of the organization or group with which they identify. The more an individual has in common with his group, the more he can actively participate to achieve group objectives.<sup>27</sup> The typical attributes of a homogeneous group are that the members work together; the jobs of members are approximately the same; the pay is equal; and they are from the same ethnic group and residential neighborhood.<sup>28</sup>

The homogeneity requirement of a similar work situation, as was mentioned for the individual, must also hold true for the group because the "we" identification from the collective groupings of individuals is further enhanced by workers who are closely associated at work. Early in the development of the industrial union, organization was advanced, in part, because of skill specialization that designated men to work side by side.<sup>29</sup> This type of environment was instrumental in permitting close physical proximity and a greater amount of communication among workers. The close physical contact of the workers permitted men to discuss common grievances at work and provided a sense of unity. The use of automation in factories has affected the traditional work group by not only re-

<sup>24</sup> Thomas E. Lasswell, John H. Burma and Sidney H. Aronson (eds.), *Life in Society* (Chicago: Scott, Foresman and Co., 1965), pp. 188-89.

<sup>25</sup> Josephine Klein, *The Study of Groups* (London: Routledge and Kegan Paul Ltd., 1956), p. 113.

<sup>26</sup> Sayles and Strauss, *op. cit.*, p. 197.

<sup>27</sup> *Ibid.*, pp. 197-98.

<sup>28</sup> *Ibid.*

<sup>29</sup> J. L. Stern, "Automation—End or a New Day in Unionism?," *Annals of the American Academy of Political and Social Science*, 250 (November 1963), pp. 26-27.

ducing the need for men, but also by breaking up many of the occupational skills and, in many cases, the close physical placement of workers.<sup>30</sup> This physical isolation has disturbed the previously high amount of social association of individuals at work.

In addition to the requirement of homogeneity of the work situation, ethnic similarities are important. One inquiry found that ethnic similarities in groups of a mill local union contributed to greater participation at meetings and provided a larger number of candidates for union office than work groups which were composed of individuals from many nationalities.<sup>31</sup> The study concluded, therefore, that active groups are more likely to contain workers with common ethnic ties.<sup>32</sup>

In addition to ethnic similarities, residential proximity is a motivating force for group homogeneity. It has been established that the social unity of a group is further increased by members who happen to live in close proximity to each other.<sup>33</sup> Thus, similar work environments, ethnic backgrounds, and close physical contact in the neighborhoods contribute to the "we" identification of group behavior.

The next factor influencing individual participation in the union group is the status or prestige of the individual in the plant community. Research by Sayles and Strauss indicates that workers who are better paid and have higher prestige are encouraged to participate because of the respect they command from their fellow workers.<sup>34</sup> The workers who participate because of this reason are perhaps tied to the loyalty of the group they are most likely to represent.

The position of the worker within the production process is also an important factor which promotes participation in union groups. Jobs which to some extent control output, seemingly have a greater amount of participation in unions than jobs that do not. For instance, if the group is a part of the initial assembly line of an automobile plant, any production slow-down or work stoppage directly affects other workers who may or may not be similarly employed. Therefore, management is highly sensitive to the attitudes of this work group; consequently, they have less difficulty in securing greater economic benefits than others.<sup>35</sup> Again, this group usually possesses prestige and status and consequently is more likely to participate because of the representation of fellow workers' interests.

<sup>30</sup> *Ibid.*

<sup>31</sup> Sayles and Strauss, *op. cit.*, p. 202.

<sup>32</sup> *Ibid.*

<sup>33</sup> *Ibid.*

<sup>34</sup> *Ibid.*, p. 203.

<sup>35</sup> *Ibid.*, pp. 207-8.

The nature of the work performed by the members of a group also is closely related to the previously mentioned group variables. Exhausting jobs hamper union activity while jobs which are not exhausting enable the worker to discuss union affairs while at work. After work, the member who is not physically exhausted participates in more union meetings and other such activities.<sup>86</sup> In addition, many manufacturing facilities work their employees in shifts, which influences participation. Union activities are difficult to schedule for second, and possibly, third shift workers, due to the times they are at work. Consequently, participation not only depends upon the amount of social association among the workers, but also upon such factors as the physical nature of the job and the time the members report to work.

The key word in this discussion has been "social." The group benefits if the work environment is social in character. If not, the individual members that do participate are on their own without the solid support and encouragement of their fellow workers. The work environment, therefore, enhances the degree of participation of a group, and, thus, the degree of activity of the individual members. However, there is another variable that attaches itself to the group and contributes to member activity. This is the method by which new members are oriented into the group.

The extent of newcomer orientation to the group is paramount in maintaining or increasing the levels of activity.<sup>87</sup> If a systematic program of member indoctrination to the group purposes and objectives is established, membership turnover is reduced. If the members are invited to participate at the start in the group activities, they are more likely to adopt the "social" characteristics of that group. These social attributes of the group are in some sense hereditary in that the group transmits these qualities to its members.

Other sociological group investigations have discussed group participation using still another approach. This is the study of primary groups. The study of primary group behavior has, only recently, sought to explain union member behavior. One prominent sociologist, Kingsley Davis, established guidelines for application of the primary group concept to unions and other contemporary groups. Writers have accepted most of his qualifications and incorporated them into a useful, definitive inquiry.

Davis divides social groups into primary groups and secondary groups. First, primary groups are described as ". . . small, durable, and intimate

<sup>86</sup> *Ibid.*

<sup>87</sup> Phillip Fellin and Eugene Litwak, "Neighborhood Cohesion Under Conditions of Mobility," *American Sociological Review*, Vol. 28, No. 2 (June 1963), p. 364.

because of both the physical and . . . the social nearness of their members."<sup>38</sup> Other characteristics of primary groups are that the members completely identify with the norms and attitudes of the group and view the social relationships as just as important as the objectives of the group.<sup>39</sup> In addition:

. . . interaction is spontaneous and engages every aspect of the persons involved. The term "primary" is appropriate, for the individual's primary loyalties, interests, affectional ties, and sympathies go to the members of this group.<sup>40</sup>

"Secondary" groups, such as the Chamber of Commerce and the Masons, become specialized and limited in scope. "Secondary" groups are separated from primary groups because they seek to fulfill limited objectives which are often subjective or personal rather than goals that are collective. For instance, the group member has only "contacts" in the "secondary" group while the individual in the primary group has friends or loved ones, such as the family, which revolve around common norms and similar attitudes.<sup>41</sup>

The explicit quality of primary groups requires certain conditions to be met before the usual "secondary" groups can be classified as primary groups. First, there must be close physical contact between members; second, the size of the groups must be relatively small; and third, member relations must be continuous and durable. If these conditions are met, the "secondary" groups, in most cases, may be labeled primary groups. The primary groups, therefore, develop certain characteristics different from other social groups in the sociological spectrum. For instance, Kingsley Davis suggests that social groups other than primary groups do not have, in most cases:

an identity of ends . . . that . . . is noncontractual, noneconomic, nonpolitical, and nonspecialized. The parties have similar things . . . and pursues as one of . . . [their] ends the welfare of the . . . [others] . . . [and that] the relationship is an end in itself; . . . the relationship is personal, . . . inclusive, . . . and spontaneous or voluntary.<sup>42</sup>

Several studies have dealt with primary groups and their participation characteristics.<sup>43</sup> One study in particular analyzed the primary group

<sup>38</sup> Lasswell, Burma, and Aronson, *op. cit.*, pp. 171-72.

<sup>39</sup> *Ibid.*

<sup>40</sup> *Ibid.*

<sup>41</sup> *Ibid.*

<sup>42</sup> Kingsley Davis, "Primary Groups," *Life in Society* (Chicago: Scott, Foresman and Co., 1965), pp. 174-75.

<sup>43</sup> E. A. Shils and Morris Janowitz, "Cohesion and Disintegration in the Wehrmacht in World War II," *Public Opinion Quarterly*, 12 (1948), pp. 23-26, and Basil G. Zimmer, "Farm Background and Urban Participation," *American Journal of Sociology*, Vol. 61, 1956 (1956), pp. 470-75.

characteristics of the German Army in World War II. The research found that rather than the German soldier being influenced by political convictions, he was influenced by the psychological primary needs that were satisfied by the social structure of the army.<sup>44</sup>

Today the concept the primary group has become an integral part of sociology. Investigations of gangs, farm migrants, and armies have produced a wealth of information concerning group members and participation.<sup>45</sup> Some studies have hinted at the importance of primary groups and their contribution to union participation, but only within their study of group behavior in general.<sup>46</sup> There is, however, one inquiry that attaches to the union the image of a primary group.

This research transferred the concept of the primary group from society's basic social units, such as the family, church, etc., and attached it to union locals. The study provided a means of transition from the concept of the family to the union local as a primary group by suggesting that many of the previously mentioned characteristics of primary groups are identifiable for union groups.<sup>47</sup>

Eugene C. Hagburg generalized that because of the satisfactions received from this type of group, the union as a primary group would influence the behavior pattern of active individuals while not contributing to the participation patterns of the inactives.<sup>48</sup> As a guide to support the concept that actives do perceive the primary characteristics of unions and their participation behavior is influenced by this observation, three hypotheses were established. First, most active members, in contrast to inactive members, tend to regard union activities as a form of primary group satisfactions; second, other primary groups influence union participation of active members as opposed to inactive members; and lastly, active members, in contrast to inactive members, derive greater satisfaction from union activities other than those obtained from accomplishment of organizational goals such as higher wages and better working conditions.<sup>49</sup>

Much of the statistical data from the study supports the original hypotheses. Actives and inactives do provide differences of opinion about primary group satisfactions. For instance, actives regard the union local

<sup>44</sup> Shils, and Janowitz, *op. cit.*, p. 281.

<sup>45</sup> *Ibid.*, Zimmer, *op. cit.*, and Frederic M. Thrasher, *The Gang: A Study of 1,313 Gangs in Chicago* (Chicago: University of Chicago Press, 1963).

<sup>46</sup> Tannenbaum and Kahn, *op. cit.*, and Sayles and Strauss, *op. cit.*

<sup>47</sup> E. C. Hagburg, "Correlates of Organizational Participation: An Examination of Factors Affecting Union Membership Activity," *Pacific Sociological Review*, Vol. 9, No. 1 (Spring, 1966), pp. 15-21.

<sup>48</sup> *Ibid.*, p. 16.

<sup>49</sup> *Ibid.*, pp. 15-16.

as a source of primary group satisfaction.<sup>50</sup> Inactives do not indicate the same type of response.<sup>51</sup> In addition, active members are active in other groups while inactives derive "satisfactions from the more traditional groups like the family, the church, and the neighborhood."<sup>52</sup> Furthermore, actives do receive greater satisfaction from union participation than merely the achievement of higher wages and better working conditions. This is not the case with the inactive member.<sup>53</sup> The investigation concludes that union organizations can increase individual participation if they develop meaningful primary relationships within the union.<sup>54</sup>

#### Union Structure Variables

ANOTHER AREA OF RESEARCH into member participation stresses the manner in which unions influence member activity. To be sure, organizational properties of the union directly affect the levels of participation. Of necessity, the size of the union influences activity by its effect upon the environment in which the member participates. As the size of the union grows, the atmosphere for individual participation diminishes.<sup>55</sup> Once the union local becomes an organization devoted to large numbers of people, much of the direct intercourse dies between leaders and members and among the members themselves. Another organizational variable is the nature of the functions the union performs for its members. If the member identifies with these functions, he is more likely to participate in carrying them out.<sup>56</sup>

As previously suggested, the growing size of unions directly affects the participation of its members. The increased size of the union may also produce a gap between the members and leaders of the union.<sup>57</sup> Despite the organizational implications of the gap, the difference in ideology of the leaders and the members will also make the member feel hopeless in achieving his personal objectives.

The gap exists because the union member identifies with the union only when it achieves what it promises, *i.e.*, higher wages and better working conditions. While the leader is concerned with these matters, "his primary allegiance is to the union."<sup>58</sup> The leader sees as important for the union much broader goals and issues. Such broader horizons include "the

<sup>50</sup> Hagburg, *op. cit.*, p. 20.

<sup>51</sup> *Ibid.*

<sup>52</sup> *Ibid.*, p. 21.

<sup>53</sup> *Ib. id.*

<sup>54</sup> *Ibid.*

<sup>55</sup> Emanuel Stein, "The Dilemma of Union Democracy," *Annals of the American Academy of Political and Social Science*, 310 (November 1963), p. 47.

<sup>56</sup> Lipset, Trow, and Coleman, *op. cit.*, p. 416.

<sup>57</sup> Stein, *op. cit.*, p. 51

<sup>58</sup> *Ibid.*, p. 52.

public image of a responsible and restrained union," as well as an interest in current social questions.<sup>59</sup> This gap is present because the two spheres concern themselves with "different problems, and . . . respond to different motivations."<sup>60</sup>

This directly observable problem "makes itself felt in living standards, in travel, in community activities, in power vis-a-vis the employer, [and] in political influence."<sup>61</sup> Consequently, the inactive member limits his activity except perhaps in times of a dues increase or strike vote.<sup>62</sup>

In addition, inactivity becomes more prevalent when unions become increasingly involved with administrative matters which necessitate the neglect of its membership.<sup>63</sup> For instance, the collective bargaining process has become so technical and specialized that members concern themselves only with the results rather than with the means. One study suggests:

It is utterly unrealistic to expect the membership will be able to pass informed judgment upon the mass of economic, actuarial, and technological considerations underlying a collective bargaining agreement.<sup>64</sup>

Even if this lack of interest is present, union leaders will often encourage the image of a proficient leadership handling administrative matters for the unions, in order "to prevent interference with the conduct of their job."<sup>65</sup>

Increased union growth has its effects in other ways. Studies have shown that there is better control of members in a small active union.<sup>66</sup> But, if the active union increases membership rapidly, some democracy is eliminated since members have a decreasing opportunity to present their views, and, consequently, participation declines. If the growth leads to deterioration of member activity and limited control over members, many raise the question as to whether more control should be established at the local level or national level. There have been strong cases for both centralization and decentralization of control. It has been often thought that centralized leadership is not in the best interests of membership participation.<sup>67</sup> However, some studies indicate that participation should not be regarded as wholly dependent upon such conditions of con-

<sup>59</sup> *Ibid.*

<sup>60</sup> *Ibid.*, p. 51.

<sup>61</sup> *Ibid.*

<sup>62</sup> George Strauss, "Control by Membership in Building Trades Union," *American Journal of Sociology*, Vol. 61, No. 6 (May 1956), p. 529.

<sup>63</sup> Lipset, Trow, and Coleman, *op. cit.*, p. 11.

<sup>64</sup> Stein, *op. cit.*, pp. 48-49.

<sup>65</sup> Lipset, Trow, and Coleman, *op. cit.*, p. 11.

<sup>66</sup> Tannenbaum and Kahn, *op. cit.*, p. 233.

<sup>67</sup> Robert Rogow, "Membership Participation and Centralized Control," *Industrial Relations*, Vol. 7, No. 2 (February 1968), p. 132.

trol, and that in some instances, there can be high levels of membership participation when leadership is centralized.<sup>68</sup>

Related to control and activity is the type of leadership within unions. If the union does have highly skilled leaders, the members tend to be active.<sup>69</sup> Stewards, in particular, significantly affect participation because many members identify with the stewards as the only liaison with the union organization. Moreover, the steward

represents and symbolizes the union to these . . . [union members], and in turn may represent their interests in the union. His actions have considerable import for integrating the members into the local. His success in this is very likely to have a bearing on the participation of his men.<sup>70</sup>

In another publication, researchers advised that as long as the steward lives up to the expectations of the members he represents, he contributes to member participation and membership control in local unions.<sup>71</sup>

Therefore, it can be stated that unions develop activity conducive to member participation by the nature of their organization and leadership. Thus, the appropriate union structure, combined with individual and group qualities, gives the individual member the environment and motivation necessary to identify and participate in satisfying his "needs."

#### Summary and Conclusions

THE NATURE OF THE INDIVIDUAL, the social and primary groups, and the union organization itself are the variables included in this study of union membership participation. It was found that any one or a combination of the above factors can structure the environment necessary for activity and involvement of the members.

First of all, the activity of union members is seen as being dependent upon various individual characteristics. Features such as class consciousness, the "gregarious" nature of particular individuals, the intensity of association away from the work place with fellow workers and union members, the extent of occupational identification and work interest, the degree of hostility toward management, and above all, the extent of economic and social rewards obtained are variables which explain the degree of participation on the part of union members.

Group variables are viewed similarly in importance. Factors such as the extent of homogeneity of the fellow group members, the physical nature and status of the job, the amount of technological importance

<sup>68</sup> *Ibid.*

<sup>69</sup> Tannenbaum and Kahn, *op. cit.*, p. 234.

<sup>70</sup> *Ibid.*, pp 234-235

<sup>71</sup> Robert L. Kahn and Arnold S. Tannenbaum, "Union Leadership and Member Participation," *Personnel Psychology*, Vol. 10, No. 3 (Autumn, 1957), p. 285.

attached to the job, and the degree of newcomer orientation seem to affect the degree of member participation. Furthermore, it appears that union member participation is conditional upon the type of primary satisfaction perceived from participating in union activities.

Union structures also are observed as conducive to participation depending upon the type of organization and its leadership. The size of the union and its relative growth is seen as influencing both the difference in ideology of the members and the effects of control measures on the membership. Each contributes to the aggregate activity of the group. In addition, the type of leader and the degree that charismatic qualities are perceived in the particular leader influence member participation.

It is apparent from the review of the above literature that certain types of individuals are more likely than others to be active participants in union affairs. Furthermore, it is noted that some group relations either positively or negatively influence rank and file members to be active in their unions. Lastly, it is seen that the structure of the particular union can have a bearing on the degree to which a given member might be active in his union. Nevertheless, there continues to be doubt as to how the various factors affecting participation are interrelated. For instance, how favorable to participation would the particular union structure need be in order to turn an individual, who has few of the characteristics of an active participant, into an active union member? Indeed, one possible area of future research would be an investigation which was designed to analyze jointly the relative importance attached to each of the factors affecting participation discussed above, *i.e.*, the characteristics of the individual, the nature of the group, and the union structure.

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